

Bank Customer Profitability Management

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ABSTRACT

The goal of the present article is to investigate and assess the directions of customer profitability management of the Latvian commentarial banks, which are aimed at promoting bank customer centricity.

To achieve the goal, the authors initially conducted content analysis of scientific literature on customer centricity. Based on the results of the content analysis, the following tasks were completed: 1) a survey questionnaire was developed, which was used in polling the customers of Latvian commercial banks with regard to bank customer centricity; 2) a model refocusing product-centric customer segmentation to customer-centric segmentation was elaborated; 3) customer bank account statements were analyzed; 4) customer ecomap was developed.

As a result of the survey conducted, it was concluded that customer centricity of the Latvian commercial banks is at the average level. In turn, the analysis of customer bank account statements, which was focused on customer centricity, demonstrated that bank customers can be classified according to these principles. As a result, three customer segment groups were identified. In the conclusion, the authors suggest elaborating ecomaps for the profitable customer segment group.

Keywords: Customer centricity, Banks, Segmentation, Profitability, Efficiency, Ecomaps, Management

1. INTRODUCTION

Banks play a decisive role in any sector of the national economy. With the increase of global competition, the issues of customer profitability management become more and more topical, which is attested by numerous studies conducted by scholars in many countries throughout the years [1; 2; 3].

Recently, bank customer centricity and customer-centric customer segmentation are mentioned as being among the most essential aspects of customer profitability management, which form the framework of business ecosystem concept. Customer centricity is defined as “*company attitude that helps to shape business processes, which is based on the recognition of the*

customer needs, thus creating long term financial value for the customers and bank” [4]. Also Yükcü and Karakelleoğlu (2013) studied the directions of customer profitability management in the context of customer centricity [5].

The goal of this article is to investigate and assess the directions of customer profitability management of the Latvian commentarial banks, which are aimed at promoting bank customer centricity.

To achieve the goal, the authors applied various research methods, such as qualitative and quantitative economic research methods and qualitative and quantitative data processing methods including statistical methods, as well as content analysis.

2. LITERATURE REVIEW

Customer profitability management based on the increase of customer value as a financial asset is mainly influenced by four factors: customer life cycle management, enterprise data base, customer quantitative value, and optimization of customer acquisition and retention costs [3]. Blattberg et al (2001) also stress that customer profitability management is based on mutual relations, however, customer needs differ depending on the time each client remains a customer [3]. In this regard, Blattberg et al (2001) distinguish five life cycle phases: 1) prospects – are not customers yet, but still reflect a potential equity; 2) first time buyers – customers, who purchased one product and service; this phase is characterized by the lowest retention rate; 3) early repeat buyers – customers, who purchased one product and service, they are more sensitive to change than first time buyers; 4) core customers – customers, who do not use products and services regularly any more, yet they are characterized by the highest retention rate and the highest sales rate per customer; 5) core defectors – are ready to switch to rival suppliers [3].

Customer acquisition stage is also considered as a transition to customer retention, which is one of the most important factors for creation of customer value [6], cost saving [7], and relationship building [8]. Considering relationship building stage, Berger and Bechwati (2001) state that in this phase if there are good mutual relationships, customers are willing to purchase additional products and services [9]. In turn, Bolton

(2004) point out that at this stage product and service price level and satisfaction can also positively affect relationships [10]. In the last phase customers may decide to switch to rival suppliers if they are not satisfied [11].

Theory and practice of relationship marketing stress that it is necessary to concentrate on development and maintaining of long-term relations [12]. However, it is important to remember that not all customers can ensure high profitability to an enterprise, therefore, it is necessary to assess customer life time value, in such a way estimating all costs and revenues associated with the customers to be able to calculate current value cash flow [13]. Fader (2012) defines CLV as the future value of the current cash flow, which is associated with a particular client, in such a way identifying the value of each customer and determining the total value of enterprise customer profitability [14]. It also helps to group the customers into segments (profitable and less profitable), improve selling techniques, forecast future tendencies, and use the resources more efficiently.

Customer segmentation, which is based on the life cycle values, can be divided into three categories: segmentation, which is based only on life cycle values; on life cycle value components; on life cycle values and other information [15; 3]. Segmentation focused on life cycle values reflects all existing customers and their relative value in the descending order, the one based on life cycle value components – existing and future value, customer loyalty, in turn, the third category takes into account also demographic data and customer transaction records [16].

There is no consensus among the scientists with regard to the concept of customer segmentation; however, they share the basic perception that it is based on the structuring of the customer base into groups, the participants of which have similar or same characteristics, ensuring effective and unique offer to the customers.

Banks continuously stress that it is necessary to change the existing strategy for a strategy of offering products and services based on customer needs. However, the existing situation in the field of financial services demonstrates opposite tendencies, banks still focus their attention on products rather than customer needs. As stated by Tseng and Piller (2003), banks should adjust products and services to customer needs instead of adjusting the customers to products and services [17]. Caselli (2005) expresses similar opinion, pointing out that banks have focused on the quality of the services offered rather than on customer centricity needs [18].

Customer-centric entrepreneurship provides additional value to the bank [19], it also ensures customer loyalty. Selden and Colvin (2003) in their research discovered that customer centricity does not only ensure profitability [2003], but also increases customer portfolio. In turn, Seybold (1998) considered that higher profitability was ensured by loyal customers [21], whereas in Seybold (2001) – by mutual relations [22]. Bolton (2004) stresses that customer-centric business processes also comprise mutual relations that ensure customer retention, satisfaction and value [10]. Hamilton (2004) has concluded that in the future, while selecting loans or other types of individual financial solutions the customers will ascribe value to trust [23].

In his turn, Fader (2012) discovered that customer centricity is the strategy that is based on reconciling of products and services with the needs of the most profitable customers, and that allows generating higher profit in longer term [14]. Galbraith (2011) has come to a conclusion that customer centricity is not an

option, but rather a necessity that is based on building mutual relations [24].

Customer-centric approach includes not only customers and their needs analysis, but also a range of other strategies. For example, Fader (2012) studies also product- and service-centric model and compares it with customer-centric model. Mello (2003) also uses the same approach as Fader (2012) demonstrating that within service-centric model initially certain products are developed and only then customer needs are considered, whereas within customer-centric model products and services are developed based on customer needs [25; 14]. Mello (2003) identified also market- and customer-centric strategy, distinguishing four main stages: preparation for customer visit, customer data processing, customer needs analysis and search for solutions [25].

3. METHODOLOGY

In order to assess customer profitability management directions, which are aimed at promotion of bank customer centricity and segmentation of the existing customers, at the first stage of research the authors developed survey questionnaires and polled the customers of the Latvian commercial banks. In the scientific literature, bank customer centricity in the view of bank customers is referred to as customer centricity index.

The questionnaires used in the research were elaborated based on the research conducted abroad by other authors [26; 27; 28; 29; 30]. The questionnaires consisted of five question blocks: from 1 till 5 (demographic data), from 6 till 20 (home pages, customer visits to bank branches), from 21 till 23 (distributive justice), from 24 till 26 (procedural justice), from 27 till 29 (interactional justice).

Justice is based on the level of customer satisfaction and future behavior, which depends on the consumer perception of the business integrity in its treatment of the customer [31]. Distributive justice derives from social exchange theory, which determines future deals; the customers will be satisfied if the invested capital is equal to the ratio of the source [32]. Procedural justice refers to fairness policy procedures and criteria; customers feel satisfied if in their view a fair decision has been made. Interactional justice shows the attitude of the service providers to the customers and problem solution skills [33].

Measurements were made on the five-point Likert scale (from 1 – strongly disagree till 5 – strongly agree), excluding the questions extracting demographic data.

The research was conducted from August to November, 2013. Customers including both natural and legal persons took part in the survey.

The research results were processed with SPSS statistical data analysis methods and were represented graphically.

At the following stages of research on the basis of content analysis of scientific literature, a model was elaborated that reflects the information on the customer demonstrating whether the bank is centered on products and services or it is customer-centric. Based on the model elaborated by the authors, customer bank account statements of ten commercial banks for the period from 1 November, 2012, till 1 November, 2013 were analyzed considering customer centricity. The analysis of bank customer

account statements was performed using NVivo software, classifying the customers into segments.

In the conclusion, the authors developed ecomaps for the profitable customer group. The essence of ecomap principles lies in representing mutual relations among the stakeholders [34].

4. RESEARCH RESULTS

In total, 187 respondents have taken part in the surveys, 59% are female and 41% – male. 43% of the respondents are aged 20-29; 36% are aged 30-39 and 21% are aged above 40. 61% of the respondents have higher education, 20% hold Master Degree, and 19% have secondary education. The responses to the questions regarding bank home page information and bank branch visit experience are summarized in Table 1.

Table 1

Customer-centric Index Measurement at the Banks by Customers

| Customer-centric index metrics | Natural persons | Legal persons |
|---|-----------------|---------------|
| Home pages, customer visits to bank branches | 3.21 | 3.31 |
| ATM availability | 4.02 | 3.65 |
| Bank location availability | 3.87 | 3.93 |
| Waiting time at the bank | 2.67 | 2.98 |
| Convenience at the bank | 2.78 | 3.03 |
| The bank knows my needs | 2.12 | 2.84 |
| Call handling quality | 4.04 | 3.89 |
| Transaction quality and speed | 4.23 | 4.08 |
| Home page quality | 4.21 | 4.30 |
| Checking costs | 2.68 | 2.91 |
| Home page information is easy to understand | 3.11 | 3.19 |
| Transparency | 2.56 | 2.77 |
| Home page search | 2.94 | 3.01 |
| Home page navigation | 2.86 | 3.03 |
| Home page speed | 4.13 | 4.17 |
| Other customer thoughts and discussions | 2.02 | 2.01 |
| Distributive justice | 2.76 | 3.00 |
| The outcome I have received is fair | 2.25 | 2.67 |
| I have not obtained what I expected | 3.85 | 3.91 |
| Provision of the required products and services | 2.19 | 2.43 |
| Procedural justice | 3.18 | 3.17 |
| The problem was resolved correctly | 2.34 | 2.57 |
| Customer complaints are not considered promptly enough | 4.21 | 3.93 |
| The bank can be flexible in solving the problems | 2.99 | 3.02 |
| Interactional justice | 2.76 | 2.83 |
| Employees focused on my problem | 2.96 | 3.07 |
| Employees did not strive to solve my problem | 2.87 | 2.91 |
| Employees did not show any interest in trying to solve my problem | 2.45 | 2.52 |
| Total customer centricity index | 2.97 | 3.07 |

Considering the data summarized in Table 1 on home pages and customer visits to bank branches, it can be noticed that in the

opinion of natural persons, the most important factors are ATM availability, call handling quality, transaction quality and speed, as well as home pages quality and speed. At the same time, legal persons ascribe the highest value to transaction quality and speed and home page quality.

The summarized data on distributive justice demonstrates that in the opinion of bank customers (natural persons and legal persons), they did not receive the expected results from the bank (Q22). The respondent rating of Q21 is 2.25 (natural persons) and 2.67 (legal persons), but the rating of Q23 is 2.19 (natural persons) and 2.43 (legal persons), which is a sign of low rating. In this regard, the banks should consider the questions that are connected with customer perception of distributive justice.

The summarized answers of respondents regarding procedural justice demonstrate that the banks do not consider complaints filed by the customers promptly enough – 4.21 (natural persons) and 3.93 (legal persons). Bank customers also consider that the problem that had been solved were not the ones they wanted to be addressed (Q24). Bank flexibility concerning solution of various issues was evaluated with average rates (Q26 – from 2.99 till 3.02).

Considering the results summarized on interactional justice it can be noticed that respondents gave very low rating to almost all questions (lower than 3 according to the Likert scale), with the exception of Q27 rated by legal persons at 3.07.

Survey results regarding bank customer centricity demonstrated that customer centricity of the Latvian commercial banks is on the average level (3.02 according to the Likert scale), thus reflecting customer profitability management problems persisting at the banks analyzed. Therefore, considering the problems persisting at the commercial banks, and based on the scientists abroad [35; 16; 36; 37], the authors developed a scheme demonstrating the transfer from bank product and service centricity to customer-centric segmentation, as it is shown in Figure 1.

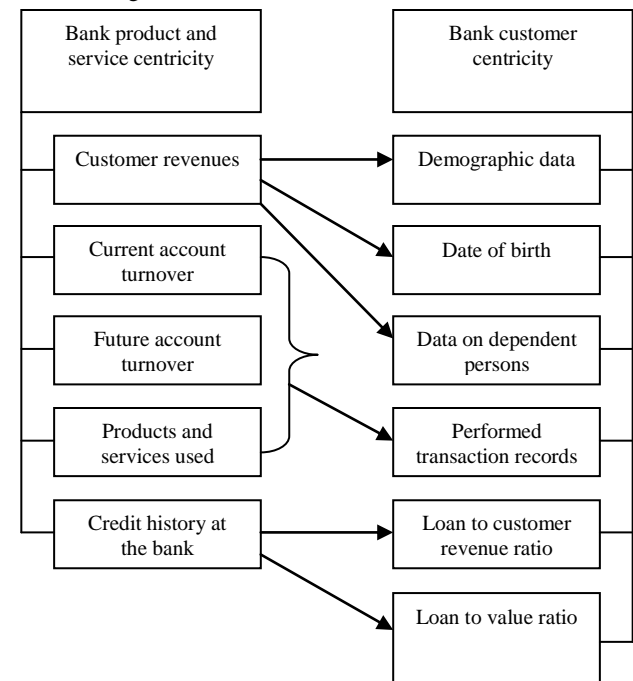


Figure 1 Customer evaluation criteria, transition from the existing centricity on products and services to customer centricity

Based on the analysis of the scientific literature and Figure 1, the author analyzed ten natural person customer account statements from several banks for the last year (from 1.11.2012. till 1.11.2013.) using NVivo software. The data obtained are summarized in Table 2.

Table 2

Analysis of customer bank account statements of natural persons

| No | Demographic data | Transaction description |
|----|---------------------|--|
| 1. | Woman, 37 years old | Monthly wage income (1000.00 EUR) Cash withdrawals <u>Standing orders:</u> Loan repayment; Transfer of life insurance premiums; Utility bills; Service bills (Latvenergo, Latvijas gāze, LMT, Internets). <u>Irregular payments:</u> Trip once a year (airplane ticket purchase, hotel bills); Payments for goods at non-food stores (mainly in August, September and December); Payments for beauty services; Payments for purchases at food stores. |
| 2. | Woman, 23 years old | Monthly wage income (EUR 426.00) <u>Standing orders:</u> Internet bills; <u>Irregular payments:</u> Payments for goods at food and non-food stores; Payments for purchases at leisure facilities. |
| 3. | Man, 31 years old | Monthly wage income (EUR 1138.00) Cash withdrawals <u>Standing orders:</u> Car leasing; Utility bills; Service bills (Latvenergo, Internets). <u>Irregular payments:</u> Fuel purchase; Payments for goods at food and non-food stores; Payment for purchases at restaurants and cafes; Airplane ticket purchase; Hotel booking and bill payments; Annual transfer of a life insurance premium. |
| 4. | Woman, 52 years old | Monthly wage income (EUR 398.00) Monthly cash withdrawal. <u>Irregular payments:</u> Payments for goods at food stores. |

| | | |
|-----|---------------------|--|
| 5. | Woman, 28 years old | Monthly wage income (EUR 569.00) Cash withdrawals <u>Standing orders:</u> Utility bills; Service bills (Latvenergo, Bite). <u>Irregular payments:</u> Fuel purchase; Payments for goods at food and non-food stores; Airplane ticket purchase. |
| 6. | Man, 68 years old | State pension (EUR 355.00) Monthly cash withdrawal |
| 7. | Man, 43 years old | Monthly wage income (EUR 1200.00) Cash withdrawals <u>Standing orders:</u> Loan repayment; Car leasing. <u>Irregular payments:</u> Payments for goods at food and non-food stores. |
| 8. | Man, 63 years old | Monthly wage income (EUR 284.00) State pension (EUR 199.00) Monthly cash withdrawal. <u>Irregular payments:</u> Payments for goods at food stores. |
| 9. | Woman, 35 years old | Monthly wage income (EUR 640.00) Cash withdrawals <u>Standing orders:</u> Loan repayment; Utility bills; Latvenergo service bills. <u>Irregular payments:</u> Payments for goods at food and non-food stores; Hotel booking and bill payments. |
| 10. | Woman, 19 years old | Scholarship (EUR 99.00) <u>Irregular payments:</u> Payments for goods at food and non-food stores. |

The data summarized in Table 1 demonstrate that it is possible to distribute bank customers into several segments according to their current account turnover based on customer centricity. Thus, based on the analysis conducted, the authors distributed bank customers into three segment groups: most profitable customers, not profitable so far, but in the future can become profitable, and non-profitable customers. This kind of typology was also used by other scientists, such as Global Information & Research Adkit (2011), Rust et al. (2000) and Fader (2012) [35; 38; 14].

Based on the research results presented in Table 2, at the next stage of the research the authors elaborated an ecomap for the profitable customer segment. The principles of ecomap introduction at the bank are shown in Figure 2.

The authors conclude that the changes in customer segmentation should be introduced in grouping the customers – natural persons, but it can be also applied regarding legal persons. Introducing and using ecomap principles in their daily work to evaluate the most profitable customers, banks will gain stable customer equity as well as will better understand their customer needs.

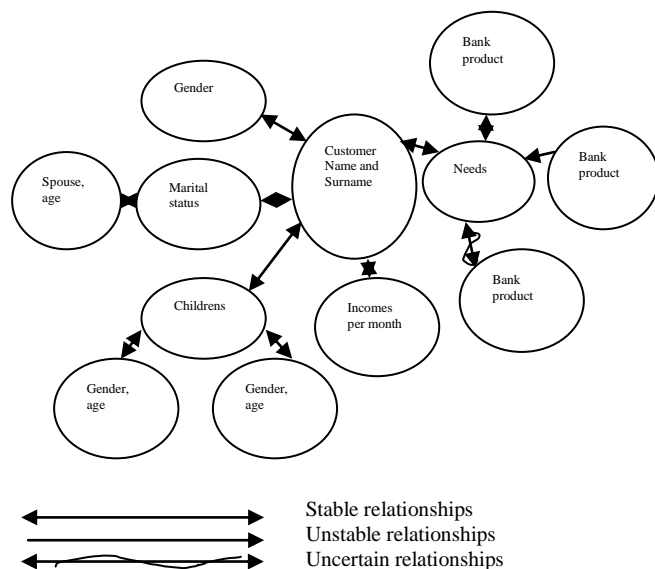


Figure 2 Example of bank customer ecomap

5. CONCLUSIONS

Conducting the research on customer profitability management at the Latvian commercial banks, the authors mainly considered the direction aimed at promoting bank customer centricity and customer-centric customer segmentation.

Using the questionnaires elaborated by the authors concerning bank customer centricity, the customers of the Latvian commercial banks – both natural and legal persons – were polled. Having conducted the survey, it has been concluded that the banks demonstrate an average level of customer centricity, as well as customer profitability management.

The next stage of the research that comprised customer bank account statement analysis considering customer centricity has demonstrated that it is possible to classify bank customers into three groups according to the level of profitability. It has also been concluded that customers, who use similar products and services as the customers analyzed, can be included into the following segment groups: most profitable customers, not profitable so far, but in the future can become profitable, non-profitable customers.

In order to ensure that the banks conduct their activities on the basis of customer-centric customer profitability management, the authors propose elaborating ecomaps for the profitable customer group. Using ecomaps, the banks will be able to understand their customer needs as comprehensively as possible, in such a way maximizing not only customer, but also bank profitability.

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