Customer Loyalty and Electronic-Banking: A Conceptual Framework

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In this paper, we present a conceptual framework that helps to better understand and assess the impacts of information technology on customer loyalty in retail banking. To do so, we define the concept of customer loyalty and identify its antecedents. A conceptual framework describing the impacts of information technology on loyalty is developed based on the literature in marketing, social psychology, and communication. The framework suggests that electronic banking might have different effects on loyalty depending on the type of customer. Research in social psychology indicates that customers can be either communally-oriented or exchange-oriented. Loyalty is thus likely to be generated differently in each case: for communally-oriented customer loyalty is likely to be generated based on social and personal interactions, whereas for exchange-oriented customers, loyalty is enhanced by service efficiency and reliability. Because it reduces the amount of face-to-face interactions customers have with bank personnel, electronic banking is likely to lead to lower levels of loyalty for communally-oriented customers and to higher levels of loyalty for exchange-oriented customers.

INTRODUCTION

Today’s banking industry is increasingly turbulent and competitive. While some North American banks such as Citibank now derive more than half of their income from abroad, several international banks (e.g., Hong Kong Bank, Banque de Paris) have recently entered the North American market. Similarly, London-based Standard Chartered Bank has recently either taken control or bought out banks in Thailand, New Zealand, and Australia. Over half of all banking sector assets are now under foreign control in Chile and Argentina (The Economist, 2000). Likewise, in Central Europe, foreign banks have increased their ownership in bank assets from 10% to more than 50% in the last five years (The Economist, 2000). In addition, numerous firms are now entering in the banking industry by offering financial products and services (e.g., Toyota’s credit card, GM’s auto financing, Merrill Lynch investments, Fidelity’s and Investors’ mutual funds).

To compete in such an environment, banks have adopted a strategy that focuses on trying to instill, build, and maintain the loyalty of clients through customer segmentation, product differentiation, cross-selling, product bundles, and establishing a long-term relationship through personal contacts. This strategy is expected to lead to increase post-purchase consumer communications (e.g., positive word of mouth) (Reichheld, 1996), decrease search motivation (Holbrook, 1978), diminish resistance to counter-persuasion (Wood, 1982), increase frequency of purchase (Reichheld and Sasser, 1990), lower price sensitivity (Krishnamurthi and Raj, 1991), and give more time for companies to respond to competitors’ actions (Aaker, 1991). The importance of establishing a relationship that fosters customer loyalty is reinforced by the fact that it can be five to ten times more expensive to win a customer than to keep an existing one (Rosenberg and Czepiel, 1984). In retail banking, the benefits associated with increasing customer retention includes a three year increase in average customer lifetime when customer retention increases by five percent, a reduction of defection rates, and an increase in account usage (Council of Financial Competition, 1995; Reichheld and Sasser, 1990; Rust and Zahorik, 1993). A significant association between customer-oriented measures such as satisfaction, repurchase intention, perceived quality, perceived value, and loyalty and financial performance measures such as ROA, market-to-book ratio, and price-earnings ratio (Anderson, Fornell, and Lehmann, 1994; Murphy, 1996).
In parallel, in an effort to offer better services and to reduce operating costs, banks invest important amounts of money into Electronic-banking (E-banking from now on). In 1998, U.S. banks invested $21 billion (US) in information technology (Ernst and Young, 1998). Worldwide, the global market for automatic teller machine (ATM) services and equipment is expected to rise from $5.6 billion (US) in 1999 to $13.3 billion (US) by 2002, and the number of ATMs is expected to surpass 1.15 million in 2004 (Cochran, 2000). Banks have also used information technology to facilitate Direct Deposit/payment (automatic deposits/withdrawals into and from bank accounts), Pay-by-Phone Systems (payment of bills and transfer of funds by telephone), Personal Computer Banking (ability to conduct banking transactions such as view account balances, transfer funds, and pay bills electronically), and Web-based banking (IFG Inc., 2000). E-banking grew from 6 to 27.5 million users between April 1998 and March 2000 in the United States alone (Yasin, 2000). Also, Sakura Bank in collaboration with Fujitsu and several other partners has recently opened Japan’s first pure virtual bank – Japan NetBank. In spring 1999, Citibank reported that 60% of all customer transactions in Hong Kong were done via ATMs or using the telephone and that, less than six months following the introduction of services over the Internet, six percent of all transactions had already moved to this new channel (Bickers, 1999). Hong Kong’s Bank of East Asia indicated that the number of customers having opened on-line accounts grew to more than 100,000 only six months after its opening (Granitas, 2000). By the end of 2002, the total number of on-line accounts is expected to reach 250 million worldwide (Lafferty Online, 2000). The end result of these dramatic changes is that more people now use self-service IT in retail banking and fewer go to branches, where the bank can establish and nurture a personal contact with clients. Consequently, a key question arises: What is the impact of E-Banking on customer loyalty? The present paper addresses this issue by developing a conceptual framework which suggests that the impact of self-service banking fundamentally depends on the type of relationships customer desire to maintain with a firm.

Research in social psychology and marketing indicates that customers vary in the type of relationship they wish to maintain with service providers such as banks. Individuals may desire to establish relationships that are more personal and friendship-like (communally-oriented customers) while others seem to value efficiency of service and prefer more impersonal and ‘at arms-length’ associations (exchange-oriented customers) (Clark and Mills, 1979, 1993). Therefore, for those customers that derive social and psychological benefits from establishing close and personal relationships with bank employees, repeat face-to-face interaction with front-line personnel may be intrinsic in establishing customer loyalty in retail banking. For these customers, human interaction during service provision may represent more than simply a conduit for service delivery, but rather, may have strong affective connotations. Largely devoid of human interaction, E-banking environments may, therefore, have detrimental effects on customer loyalty for these patrons. Conversely, it is suggested that for customers whose relationship with banks is primarily anchored in the efficiency of its services (i.e., the employee’s ability to provide reliable, accurate, and timely service), traditional and E-banking environments may be perceived as being highly substitutable. It is suggested that, for these customers, salient factors affecting their loyalty will largely be cognitive, based on technological innovation, IT performance, and the breadth of services offered over electronic channels.

In the following section, we define loyalty and identify its antecedents. In the next section, we propose a conceptual framework that describes how E-Banking is expected to affect loyalty and its antecedents. The paper ends by presenting a discussion of the framework and presenting its implication for research and practice.

CUSTOMER LOYALTY

Despite the reported benefits of loyalty and its links to financial performance, a review of marketing literature indicates that there has long been disagreement about what represents customer loyalty and how it should be measured. Generally, assessing customer loyalty to a seller, manufacturer, or service provider has often consisted of using either actual purchase behavior or customer self-reports. For instance, Newman and Werbel (1973) consider loyalty as repurchase behavior and Tellis (1988) equates loyalty with repeat purchase frequency. Massey, Montgomery, and Morrison (1970) see loyalty as a probability of purchase while both Cunningham (1966) and Neal (1999) view loyalty as a proportion of a customer’s purchases. Segal (1989) has gone as far as to suggest that a customer is loyal if more than about 90% of his or her purchases are to a single supplier. It has been suggested that behavioral data is easier and less costly to collect (Dekimpe, Steenkamp, Mellens, and Abeele, 1990) and that it may be superior to attitudinal data because it represents how customers actually behave instead of how they merely feel (Colombo and Morrison, 1989). Nonetheless, behavioral measures are not problem-free. Several authors have cautioned against using and interpreting behavioral data to gauge loyalty and have criticized the setting of arbitrary cut-off margins to assess whether a customer can be classified as loyal or not. In addition, customer loyalty is often conceptualized as a dichotomous variable (i.e., either ‘on’ or ‘off’). However, several authors have argued against this and have suggested that loyalty represents a dynamic, temporal, and continuous concept. For instance, Fournier and Yao (1997) suggest that, often consumers are classified as loyal or disloyal based on some arbitrary cutoff in purchase-share qualifications, which precludes attention to loyalty levels and types. Finally, using purely behavioral definitions and measures of loyalty tends to overestimate true levels of loyalty. In fact, by simply observing overt behavior one cannot differentiate whether a customer’s...