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Effects of Customer Retention Strategy on Performance of Commercial Banks in Kenya

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Abstract: ***Banking services in all markets, including emerging markets, are undergoing major transformation that is driven by change, deregulation and customer sophistication. Customer retention in particular is crucial to attaining a sustainable competitive advantage, in the market place. This study was designed to examine the effects of customer retention strategy on performance of commercial banks in Kenya. In order to capture the required information, the study was guided by four objectives; to determine the effect of location on the performance of commercial banks in Kenya; to determine the effect of credit process on the performance of commercial banks in Kenya; to determine the effect pricing on the performance of commercial banks in Kenya; and to determine the effect of Customer service on the performance of commercial banks in Kenya. The Study employed a descriptive survey design utilizing both primary and secondary data. Thirty five copies of Structured and unstructured questionnaires were used to collect primary data and were administered to five commercial banks in tier I through "drop and pick later" method while secondary data was collected through literature and document review. The postulated objectives were tested by employing the Pearson Correlation statistical tool which was facilitated by the statistical package for social sciences (SPSS), while the main method of data presentation was frequency distribution tables. Location was found to have a significant effect on performance of commercial banks; banks invested in opening more delivery channels that guaranteed higher customer retention. Credit process had a significant effect on the performance of the banks. Most banks were striving to remove bottle necks in credit decision making process and reduction in turnaround time of processing credit requests. Findings also showed that pricing and customer service had a direct impact on the performance of the commercial banks. The study therefore concludes that commercial banks in Kenya should increase customer identification and retention strategies since they commensurably impact on their level of performance. The study recommended that the key to efficient performance of commercial banks in Kenya is pegged on their ability to identify, attract, retain and develop their customers better than competitors.***

Keywords: Location, Credit Process, Pricing, Customer Service

1. Introduction

Customer retention refers to customer's stated continuation of a business relationship with the firm, (Timothy et al., 2007). The banking industry is highly competitive, with banks not only competing among each other; but also with non-banks and other financial institutions, (Hull, 2002). Most bank product developments are easy to duplicate and when banks provide nearly identical services, they can only distinguish themselves on the basis of price and quality. Therefore, customer retention is potentially an effective tool that banks can use to gain a strategic advantage and survive in today's ever-increasing banking competitive environment, Bara (2001).

In the last two years, the European banking market has witnessed unprecedented turmoil as it has undergone a period of massive uncertainty and change. With the Commercial Banks that had enjoyed record profits in 2007 now the subject of intense public scrutiny and, in many cases, the beneficiaries of taxpayer-funded support, an impact on customer retention seems inevitable, (Ernst & Young, 2010).

In Eastern Europe, specifically Russia, successful customer retention starts with the first contact an organization has with a customer and continues throughout the entire lifetime of a relationship, (Atieno, 2001). A Bank's ability to attract and retain new customers, is not only related to its products or services, but strongly related to the way it serves its existing customers and the reputation it creates within and across the marketplace. In New Zealand, customer retention is an important element of banking strategy in its increasingly competitive environment, (Gale & Wood, 2003). The author further noted that financial institution management in the country always identifies and improves upon factors that can limit customer defection.

Organizations worldwide have various ways of enhancing their customer retention although the ways vary from one organization to another depending on the actual functions of each organization, (Gopaal, 2007). This is done in a bid to improve customer satisfaction with the organizations. Customer retention strategy has emerged as the most important phenomenon in organizations in that it enables managers to harness the energies of all customers to determine their strength and maximize both customer retention and satisfaction, (Kakuru, 2000). The success of any commercial bank involved in process of credit services and lending money to its customers should rely on its credit policy, which in any case should be developed with customer needs and expectations at the back of their mind, the neglect of which can lead to lending disaster, (Awava, 2002). It is probable that commercial banks should follow a logical approach taking each important factor in financial services one at a time and assessing with the pending preposition, (Alarcon, 2008).

As Kelvin, (2006) points out, customer loyalty is all about driving perceived value, whether that is rational (functional, quality, cost, etc.), emotional (trust, service, communication, information, and brand equity) or a combination of these two dimensions. First, identify what leverages top-end customer commitment and advocacy behavior, and then

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build customer experience around it. According to Lowenstein (2001), there is no standard schedule for how often to communicate with customers to build loyalty. In his research, customers reported an interest in receiving communication from suppliers as long as they could see personal value in each message.

In Kenya, commercial banks operate with a view to realize a profit on the services advanced to the customers, and for the recipient to better her economic life in terms of breaking the poverty cycle. However for this to happen, the cost involved either side has got to be analyzed, measured, and translated into the strategy effected in the performance of the commercial banks. Over the last ten years, commercial banks in Kenya have continued to grow in assets, deposits, profitability and products offered. The growth has mainly been attributed to fostering loyal customers. It costs retail banks as much as six times more to attract a new customer as it does to retain an existing one, and yet for many years the industry has not always focused on customer loyalty and the opportunities among its existing client base, (Ernst & Young, 2010). Commercial banks such as Equity, Barclays, Chase, and K-Rep in Kenya advance credit to customers with a view to make profit. Thus delivering high quality service to clients is just as important as delivering performance that meets or exceeds their expectations. Customers naturally gain a sense of security placing their money in an institution they believe shares their interests, and the nature of their precious finances means they need to know those interests are being catered for, (Kambugu, 2002). It is therefore of utmost importance that commercial banks in Kenya do understand and appreciate those service attributes that appeal to their customers in order to satisfy them and ultimately retain them for continuous business.

Therefore, it is against this background that this paper is based in order to assess the effect of customer retention strategy on performance of Kenya's commercial banks.

Specific Objectives

1. To determine the effect of location on the performance of the commercial banks in Kenya.
2. To determine the effect of credit process on the performance of commercial banks in Kenya.
3. To determine the effect of pricing on the performance of commercial banks in Kenya.
4. To determine the effect of customer service on the performance of commercial banks in Kenya.

This chapter focuses on studies done on Customer retention strategy and performance of commercial banks and relationships are determined between variables so as to reach conclusions. The material is sourced from books, journals and reports both in print and electronic media.

2. Literature Review

2.1 Theoretical Framework

In this section, several thoeries was highlighted to strengthen the study. Extensive research has been performed to find out what makes customers remain to a given bank and how the retenton affects its performance. A number of theories have been developed even though there is no universally acceptable customer retenton theory. Understanding of these theories will facilitate the managers to get a better insight into customer behaviour. Some of the theories that was discussed include customer satisfaction theory, product life cycle theory, social exchange theory and theory of product differentiation.

2.1.1 Customer Satisfaction Theory

Customers may express high satisfaction levels with a company in a survey, but satisfaction does not equal loyalty. Loyalty is demonstrated by the actions of the customer; customers can be very satisfied and still not be loyal. Peter Chereton (2001), states that loyalty does not result from monopoly because when there is a new entrant into the market most customers will jump ship the novelty wears off, then the customers looks elsewhere. It also does not come about because of discounting. True loyalty results from the relationship between the suppliers and the customer and the brand is a vital vehicle for defining and managing that relationship. The most dominant theory of customer satisfaction is the expectancy-disconfirmation model. According to this theory, satisfaction outcomes are a function of perceived performance and perceived disconfirmation. Perceived disconfirmation depends on perceived performance and standard for comparison. Standards of comparison may include expectations, ideals, competitors, other service categories, marketer promises and industry norms. If perceived performance is significantly worse than the comparison standard (more than the customer is indifferent to), a customer will experience negative disconfirmation (service did not meet the comparison standard). It does not matter how the service provider believed the service was performed. It is especially important for managers of business services to recognize negative disconfirmation, as it presents the largest threat to customer loyalty, word-of-mouth recommendation, repeat purchases, and other desirable customer responses.

2.1.2 Product Life Cycle Theory

Product Life cycle is a major component in customer retention for commercial banks. Vernon (2001), focused on the product (rather than the country and the technology of its manufacture), not its factor proportions. He noted that products have a life cycle and hence there is need to understand this cycle for the purpose of designing a product and putting it in the market. Introduction- This is the time for high investment and show uptake. Growth - If it takes off with resultant volumes bringing costs down so fuelling more growth. Maturity- The product success brings in competitors to share the spoils during which the sales curve again flattens, and revenue is generated predominantly by sales to existing customers rather than to new customers. Saturation- Too many players lead to crowding. Decline- Suppliers lose interest and the product declines towards death. The knowledge of the above cycle serves to enable the commercial banks to comparative use, advisory use, and the dynamic use. Hence there is need to understand the major stages that product is undergoing in order to determine where it has reached, (Kinnear, 2000). Commercial banks need to offer a wide range of products to deal with the different customers' requirement. In order to do this there is need to understand how different customers behave or make

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decision to buy a product or an offering, (Byrne, 2003). In addition, Forrester (2007), indicates that the typical customer life cycle of a financial services includes opportunities to improve the customer experience at every stage.

Therefore, the best practices for each stage in the customer experience life cycle are: target the right customers with the right value proposition, start a positive relationship through acquisition, incorporate customer advocacy into day-to-day service and develop relationships to increase stickiness. The theory will inform the study by allowing analysis of how new products innovation will play a role in contributing towards improved performance of the commercial banks.

2.1.3 Social Exchange Theory

Thibaut (2000), suggested long term relationships go through four stages: sampling - costs and rewards are explored; Bargaining - negotiation of rewards and costs are agreed; Commitment - exchange of rewards and acceptance of costs stabilize, there is now focus on relationship; and Institutionalization - norms and expectance are firmly determined.

The main idea behind social exchange is everyone tries to maximise the rewards they obtain from a relationship and try to minimize the costs. If the relationship is to be successful then both parties are expected to give and take in equal proportions, (Kelley, 2002). Social exchange theory is a major component in customer retention for commercial banks in that they benefit from successful relationships with their customers.

2.1.4 Theory of Product Differentiation

When looking at differentiation, four main factors have been identified as characterising a service : intagibility, inseparability, heterogeneity and perishability (Zeithalm & Bitner, 2003). The theoretical model of endogenous reference-dependence of Ok, Ortol-eva and Riella (2011), is applied to the theory of vertical product differentiation. The standard problem of a monopolist who offers a menu of alternatives to consumers of different types is analysed, but allows them to exhibit a form of endogenous reference dependence like the attraction effect.

Egan (2004), has been noted as one of the first to introduce the concept of relationship marketing which he defined as the attracting, the maintaining and the enhancing of customer relationships. Commercial banks must be innovative and should offer attractive products that guarantee retention of their customers.

2.2 Conceptual Framework

A conceptual frame work can be defined as a set of broad ideas and principles taken from relevant fields enquiring how to structure a subsequent presentation (Reichel & Ramey, 2007). As a research tool, it is intended to assist the researcher develop awareness and understanding of the situation under scrutiny and communicate it. The conceptual framework of this study will include independent variables, location, Credit process, pricing and customer service. Independent variables are the factors that the researcher thinks that they will explain the variations while the dependent variables are those that the researcher attempts to predict (Orodho & Kombo, 2002). The conceptual framework identifies the independent variables that affect the dependent variable which is performance of commercial banks in Kenya.

3. Research Gaps

A number of studies have been done relating to customer retention and its effect on performance but few have exploited on the implication of performance of banking institutions. Commercial banks are reactively rather than proactively trying to hold onto customers due to lack of clear metrics on what attrition is and no enterprise focus on the problem, Pilecki (2007). According to him, customer retention is a process, not an event.

To ensure success of customer retention strategy, it is important to consider the uniqueness of the situation and the diversity of the customers, (Khan et al., 2010). This is because a critical understanding of what works and what does not work is central in designing and managing effective customer retention strategy.

Previous researchers have recorded the importance of customer retention in an effort to improve performance of commercial banks. However, there still lacks in depth understanding of which strategy is ideal for customer retention. To fill the gaps, the study aimed at determining the effects of customer retention strategy on performance of commercial banks in Kenya.

3.1 Data Analysis and Presentation

Data collected for the study was compiled, sorted, edited, classified, coded and analyzed using a computerized data analysis package known as SPSS 20.0. Descriptive statistics was used to depict the characteristics of the population. The mean and the variance were calculated using SPSS. This study used multiple linear regression. In general a four variable linear regression model of the form illustrated below was used:

$Y_i = \beta_0 + \beta_1 X_{i1} + \beta_2 X_{i2} + \beta_3 X_{i3} + \beta_4 X_{i4} + \varepsilon_i$

Where:

Y_i = Performance in commercial banks

X_{i1}= Location

X_{i2}= Credit process

X_{i3}= Pricing

X_{i4} = Customer service

ε_i= Is the error term

β_0 = intercept

β_i= Are the unknown parameters (regression coefficients).

The model helped in determining if there is a relationship between customer retention strategy and performance of commercial banks in Kenya.

Correlation analysis is a statistical technique which is used to determine the strength of relationship between two variables.

This relationship can be linear or inverse. A numerical measure of this relationship is called Pearsons'correlation coefficient(r):

The strength of relation is quantified as;

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r = 1; shows a direct linear relation between variables
r = 0; shows that there is no relationship between variable
r = -1; shows a direct inverse relationship between variables.
r > 0 ; shows some direct linear relationship between variables
r < 0 ; shows some inverse relationship between variables
In this research, correlation analysis was used to determine the strength of relation between the performance of commercial banks in Kenya and location, credit process, pricing and customer service.
Chi-square test of independence is a test used to determine whether one variable is independent of the other. It uses contingency tables to evaluate the independence under the null hypothesis of independence between variables.
In this research, chi-square test of independence was used to test the independence between the performance of commercial banks in Kenya and location, credit process, pricing and customer service.
From the results obtained, interpretation and generalization was made and thereafter conclusions were drawn.
Qualitative data which involves quality or kind was measured through interviews to understand customers and employees behavior. Further the researcher used qualitative to understand how customers and employees feel or what they think about their institutions. Quantatitive data was based on measurements or quantity or amount.

3.2 Data Presentation

Quantitative data was presented using Frequency tables, Pivot tables and Contingency tables.
Qualitative data was derived from the open ended questions in the questionnaire. The responses were assessed thoroughly and organised in to various categories, distinct from each other and the relationship among the identified categories established. Codes were used to generate themes and categories. Once the themes, categories and patterns were identified, the study evaluated and analysed the data to determine the adequacy of the information and the credibility, usefulness, study consistency and validity in answering the study question. From this information, the study developed narratives and interpretive report in order to explain and reflect the situation within the commercial banks.

4. Methodology

There are 43 listed commercial banks (Appendix III). The banks are arranged in terms of tier one, two three and four. The target population of this study comprised of 736 employees and customers of the five banks in tier one. The sample size comprised of 35 employees and customers.

Sampling is the process of selecting respondents from the target population, (Mugenda, 2008). In a statistical survey with varying population ; it's advantagoues to sample each sub group independently. Each element in the population is assigned to only one subgroup and no element should be excluded.
The sample size was arrived at using the following formula:

$$n = \frac{NC^2}{C^2 + (N-1)e^2}$$

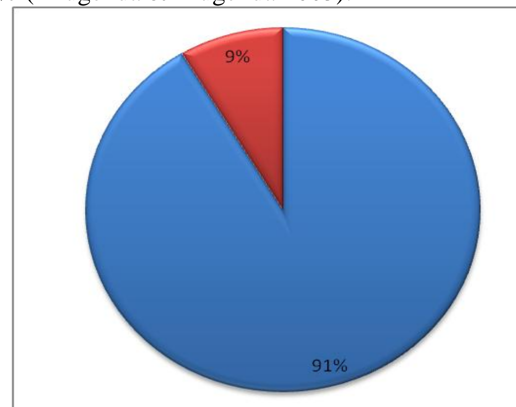
Where, n, is the sample size,
N, is the population size,
C, is the coefficient of variation which is $\leq$ 30%, and
e, is the margin of error which is fixed between 2-5%
The study sample was calculated at thirty percent coefficient of variation and five percent margin of error. Thirty percent coefficient of variation was used to ensure that the sample is enough to justify the results being generalized for the banks. Higher coefficients of variation were not used to avoid very large samples due to time and financial constraints. Five percent margin of error was used because the study necessitated relatively higher margin of error.
Thus the sample size was determined through the following calculations;

$$n = \frac{736*(0.5)^2}{0.5^2 + (736-1)*0.05^2} = 35$$

The sample size comprised of 35 employees and customers.

5. Results and Discussion

The study was able to get a response from 32 respondents out of the 35 questionnaires distributed to the respondents in the study area. This response rate was considered adequate for reporting as it exceeded the generally accepted threshold of 50% (Mugenda & Mugenda 2003).



Respondents by Age
The results indicate that 65.6% of the respondents were in their middle age between 20 and 40 years. This means that most of the banks employee population was made up of the middle age bracket.

6. Location

The findings indicate that the banks had opened agencies (68.8%) and many ATMS (46.9%) to continue serving customers conviniently in places where there were no branch presence. Most of the banks pofitability increased (43.8%) as more branches are opened. Based on the findings the respondents indicated that their banks had opened agencies (40.6%) where there were no branches and that more branches and delivery channels were necessary for higher performance (40.6%).

7. Credit Process

It was evident that credit underwriting practices are applied clearly objectively and consistently (31.3%). The respondents also felt that the credit history for customers is

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considered in the underwriting process (50%) which means customers retention is important in credit decision making. The results also reveal that credit reference checks are part of credit underwriting (50%) which implies that the banks are keen to reduce credit extension to potential defaulters. The results further show that management classifies borrowers based on repayment record (62.5%) which also reduces chances of default whereas this encourages growth of a healthy loan book due to repeat borrowing by the retained customers. Turnaround time in processing loan applications was low (50%) and that the banks have streamlined decision making to remove bottle necks in loan processes (68.8%).

8. Pricing

The findings revealed that products are priced based on individual customer relationships (40.6%). Profitability was not the key pricing objective (37.5%) which meant that there are other factors such as administrative costs, risk score and expenses that determined pricing. The findngs also reveal that there should be a loyalty on discount to loyal customers on loan interest and bank charges (37.5%). The findings also reveal that pricing conveys a corporate image of a bank (50%) since customers are able to compare pricing from one bank to another and will settle for the low priced one. Most (71.9%) of the respondents also felt that their bank is concerned with customer price sensitivity and elasticity issues. Banks adhered to legal restrictions on price maintenance (62.5%) majorly on the base rate which is determined by the CBK. Most banks did not display their pricing tariff (65.6%) and customer had to make enquiries about tariffs prior to accepting offer letters to various products.

9. Customer Service

The findings in the study suggest that the banks had a clear picture of what the key customer segments are and how they can be assisted to meet their needs (39.5%). Proactive retention programmes that identify customers who are likely to attritite were available (59.2%) and such customers were interviewed by the banks in a bid to retain them and avoid losing them to competion and that sales and service representatives are trained to recognize retention threats (53.9%). The findings revealed that most banks (56.3%) have a simple, expedited process for opening a primary account with its commonly cross-sold products. The results also reveal that the banks have an incentive compensation programme in place that rewards for saving customers (50%). Finally, automated services such as ticketing and internet have improved customer service and retention (71.9%). These findings imply that most banks were embracing more tehnology oriented solutions such as automated loan orignation systems and virtual banking.

10. Conclusions

From the foregone discussion on the observed findings, we conclude that a significant relationship exists between customer retention strategy and the performance of commercial banks in Kenya. Customer retention contributes highest to bank market share, growth and profitability. Consequently, the implication of the study are that Kenyan banking sectors should generally increase their customer retention strategies so as to enhance their level of business viability and specifically review their customer attraction and retention policies in order not to lose customers to competitors. Based in the above, we conclude as follows:

That the key problems of customers' retention strategies are influenced by a series of distinct gaps often neglected byt the commercial bank. Therefore, a key challenge for commercial banks and scholars in this field is to device methods to measure these gaps accurately in the market.

Secondly, that although some variables exhibit weak associations, further research is needed to examine the nature of the association between customers' retention and its determinants.

Thirdly, the usefulness of segmenting consumers on the basis of their expectations is worth exploring its possibilities with the commercial banks.

11. Recommendations

The management of commercial banks should charge competitive interest rates, favorable account charges and administrative fees that will guarantee customer retention. Favorable fees and charges will reduce chances of credit facilities being defaulted and further, the customers will not move to other competitors.

Commercial banks should introduce more credit products in their institutions to improve customer retention. There is need for management to ensure that staff members are well trained and are aware of the credit products and policy in place. Finally it is also recommended that commercial banks should attempt to segment their market to match customer needs and firm capabilities by managing customer base via effective tie ring of service delivery of quality services as well as conducting churn diagnostic monitoring of declining/defecting customers.

11.1 Suggestions for Further Research

The main aim of the study was to determine the role of customer retention strategy on the performance of commercial banks in Kenya. More studies need to be done on customer satisfaction, and customer relationship management and whether there exists an impact on the performance of commercial banks.

Although some variables exhibited weak associations, further research is needed to examine the nature of the association between customers' retention and its determinants.

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