The Effectiveness of Customer Loyalty Strategies in the Spanish Banking Sector

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Abstract

The present study sets out to analyze the implementation and effectiveness attached to customer loyalty strategies in the Spanish banking sector. Results of a survey completed by fifty-three Spanish financial institutions show that the implementation of customer loyalty strategies is widespread, with the exception of "scientific marketing" and "customer relationship management (CRM) tools", whose use is high but not widespread. Regarding the effectiveness of these strategies, are precisely those tools "scientific marketing" and "CRM", which suggest a greater positive effect on customer loyalty.

Keywords: Customer loyalty. Client portfolio. Scientific Marketing. CRM. Financial Sector, Spanish Banking Sector.

1. Introduction

According to a report by the Conference Board (quoted in Daemon Quest - 2007), U.S. firms on average lost 50% of customers every five years, so there is a great concern to reduce customer churn, so that customer loyalty is considered a strategic priority for the presidents and CEOs of these companies. Oversupply in most sectors of developed economies makes it more difficult and expensive to attract customers. Therefore, companies realize that customer loyalty is crucial in order to assure the desired levels of growth, profitability, and long-term survival (Heskett et al., 1997). In the current climate of increased competitiveness, firms are (re)structuring their organizations to generate more value for their clients in what Porter (1985) defines as a differentiation strategy.
The Spanish financial industry shares many of the aforementioned characteristics of mature markets, with elevated levels of competition among participants (Castillo et al, 2011). This situation is due to several factors that have been developed in the last 20 years, among which we highlight both the gradual increase in the number of entities participating in the market, and that consumers have a higher level of financial literacy and more complex needs to cover than in the past, so that they demand a level of service more comprehensive and tailored to its specific needs, all in a context in which such consumers have easier the comparison between different product offerings, which facilitates the transfer from one provider to another, ie. the "switching costs" were reduced significantly.

Fainé and Tornabell (2001) indicate that survival in the financial sector is determined by the capacity to anticipate clients' needs and provide quality service, thereby increasing customer loyalty. In this paradigm, the traditional 'P's of the marketing mix: product, price, place, and promotion give way to the three 'R's of relationship marketing: relate, retain, and recovery. Numerous strategies have been developed in order to systematically encourage customer loyalty. As described in section 3, this paper studies how common these strategies are within the context of Spanish financial institutions, and their effectiveness ºin increasing customer loyalty.

The methodology of the study consists of a questionnaire delivered by mail to 53 Spanish banks and savings banks. Results and conclusions are presented in sections 4 and 5, respectively.

2. Literature Review

2.1 Customer Loyalty

According to Huete at al. (2003), developing customer loyalty implies reducing drop-out rates (or inversely, increasing retention rates). Reinares and Ponzoa (2002) develop this idea by insisting on the fact that loyalty is a measure of the intensity of the client's relationship with the brand or company. It also represents a barrier for brand-switching to competitor's offerings. Therefore, as Bigné and Andreu (2004) point out, customer loyalty is a concept that does not only encompass repeat purchases but also satisfaction and a sense of affective engagement with the brand. Studies on the relationship between customer loyalty and company profits were collected by Fainé and Tornabell (2001). According to them, a 2000 study on US banks shows that a 2% increase in the retention rate has the same effect as a cost reduction of 10%. Furthermore, a 20-year old client contributes 85% more income than a 10-year old client. Daemon Quest (2005) calculates that retaining 25% of high-value clients increases operating profits by 15%.

An explanation of the relationship between loyalty and profitability is provided by Reichheld and Sasser (1990), who posits that there exist six "high tension cables" that convert increased loyalty into higher profits. The connectors that explain these loyalty-driven sources of profitability are: a) repeat sales of the same product or service; b) cross-selling or up-selling practices; c) referrals processes and/or member-get-a-member (MGM) programs, which generate up to 50% of new clients in certain sectors; d) diminished price sensitivity in loyal clients; e) reduced use of company resources by loyal clients, since they are familiar with the company's processes and products; f) the fact that loyal clients require a smaller marketing expense, in comparison with that required to acquire new clients. Ashley and Varki (2009) identify another profitability driver for loyalty: loyal clients are prone to complain directly to the company instead of spreading negative word-of-mouth comments, therefore damaging the firm's reputation.

Previous literature has identified numerous factors that influence customer loyalty. The first of these is satisfaction, which has been defined by Kotler et al. (1995) as the positive result of comparing "perceived value" with "expected value." A considerable cohort of scholars consider that affective elements must also be included in this definition (Sanzo et al., 2003; Bigné and Andreu, 2004; Bigné et al., 2010). Mägi (2003), Fandós et al. (2009), Liang and Wang (2008), as well as Ashley and Varki (2009) find a direct link between satisfaction and loyalty. Furthermore, quality is a determinant element of satisfaction and therefore influences customer loyalty (Del Río et al. 2001; Cronin et al. 2000). Other factors are trust in the company's ability to fulfill expectations (Garbarino and Johnson, 1999; Gommans et al., 2001) and physical or mental switching costs (Jones et al., 2000; Apaolaza et al., 2004). Finally, a sense of commitment –for rational or emotional reasons– also has a positive effect on loyalty (Demoulin and Zidda, 2009; Lacey and Morgan, 2009).

2.2 Loyalty Strategies

Loyalty strategies may be categorized according to their principal goals. Previous research identifies two broad groups: a) "costumer heterogeneity management", in which specific marketing activities are designed for different customer purchase behavior profiles (Lacey and Sneath, 2006; Nunes and Dréze, 2009); and b) "customer relationship management", in which efforts are made to modify consumer behavior in order to increase the value of the relationship over its entire life cycle (Meyer-Waarden and Benavent, 2003; Uncles et al., 2003; Reinares et al., 2010).

The first step in customer heterogeneity management is *to segment the customer base* in order to identify consumer groups with different needs and buying behaviors. Each segment can then be offered products and services that better suit its needs. In the financial sector, nowadays it can be outright harmful to design a unified marketing strategy for the entire client base (Cortiñas et al., 2005). While this type of personalization is already being put into practice for a small group of clients (particularly in private banking), a future challenge for the financial industry is to introduce a reasonable level of personalization to larger segments in what Mas (2003) defines as "mass customization strategies."

In essence, combining a standardized approach with personalization elements can be a cost-effective way of increasing the client's perceived value, satisfaction, and therefore loyalty to the financial institution (Huete et al., 2003). For customer segmentation to be effective, two other strategies are necessary: *differentiated marketing strategies for each segment* and as a consequence of above, the subsequent *creation of client portfolios for each segment* in order to manage marketing efforts through individualized channels. The successful implementation of these loyalty strategies in customer heterogeneity management requires the collection and management of large amounts of client data. Information on current and future behavioral and consumption habits is essential if an individualized marketing approach is to replace the traditional mass marketing approach[1]. In order to obtain positive results from the loyalty-development process, it is key to have information in sufficient quantity and quality, as well as appropriate systems to internally disseminate this information (Day, 2003). For this we need *to have tools of "scientific marketing"* (datawarehouse, datamining, neural networks, among others), that collect, analyze, and incorporate information on all interactions with the client, and whose implementation in the Spanish financial sector as loyalty strategy, will also be analyzed in this study.

Furthermore, loyalty programs have customer relationship management as a second goal. Relationship marketing processes aim to develop customer loyalty. If a company has strong relationships with its customers –in other words, it knows them and can offer products and services that they want– then they will show loyalty (Reinares and Ponzoa, 2002). This leads to other loyalty strategy or *multichannel strategy*, which consists of reaching the client through a multitude of communication channels (virtual and/or physical), looking for a differentiated service that enables have a competitive advantage, and also enhance trade capacity of the entity.

Finally, the implementation of the multi-channel strategy in the financial sector has increased customer interactivity, using each of the channels according to their needs, and beginning to demand greater coordination and service all of them. To meet this need arise CRM tools (customer relationship management), which allow to collect, analyze and integrate all the information arising from the relationship with the customer regardless of the channel through which it has occurred. The objective of CRM is to understand the customer needs, and satisfy them through the channel the customer chooses in each moment. *The implementation of CRM tools* in Spanish financial institutions is the last loyalty strategy that will be discussed in this research.

3. Goals and Methodology

3.1 Goals

The primary goal of our empirical analysis is to ascertain the implementation of loyalty development strategies (as described in section 2) among Spanish financial institutions. The secondary goal is to verify the effectiveness of these customer loyalty strategies in this sector. The authors studied the evolution of the “churn rate” for the past five years of the entities participating in the research, crossing this evolution with the implementation of the loyalty strategies considered in the study. The previous literature described in section 2, identify the “churn rate” as one of the best factors to measure customer loyalty.

3.2 Methodology

This paper studies the two main groups of financial institutions in Spain –banks and savings banks– holding 95% of the sector's assets. Banco de España provides a list of all financial institutions in its 2008 Statistical Bulletin. From this list, the authors excluded the smaller and non-retail banks, where loyalty systematic strategies have lower development. The final group of 16 banks and 37 savings banks holds 92% of the sector's assets.

Primary data was collected from mail and online surveys sent out to the marketing directors of participating institutions. 40 institutions replied, resulting in a response rate of 72.7%, that it represents 88.6% of total assets in the Spanish banking sector.

[1]According to research by Unysis Corporation and The American Banker, 46% of US banks that utilize a customer information system have a client retention ratio of over 90% versus 17% of banks that do not (“Customer Focus in Retail Banking: Opinions & Practices at 150 Top Banks,” 2000).

Table 1: Technical specifications

Universe	Spanish financial institutions (banks and savings banks) with retail presence
Sampling method	Random: survey sent to financial institutions in the universe
Data collection method	Online and mail questionnaire
Surveyed position	Marketing Directors
Population	53
Sample size	40
Confidence level	95% (z=1,96; p=q=0,5)
Sampling error	7,7%
Information collection period	November 2, 2009 to February 28, 2010

4. Findings and Results

Regarding the first goal of the research, results on the implementation of the different loyalty-development strategies among Spanish banks and savings banks are shown in Table 2.

Table 2: Implementation of loyalty-development strategies

% of Institutions	*Not in use*	*Future implementation*	*Implemented 1-2 years ago años*	*Implemented 3 or more years ago*
Client segmentation	*0%*	*0%*	*0%*	*100%*
Differentiated marketing strategies for each segment	*0%*	*0%*	*20%*	*80%*
Client portfolios	*0%*	*0%*	*27,5%*	*72,5%*
Multichannel strategy	*0%*	*0%*	*22,5%*	*77,5%*
Scientific marketing tools	*0%*	*32,5%*	*52,5%*	*15%*
CRM tools	*0%*	*25%*	*32,5%*	*42,5%*

The results show that the first four loyalty-development strategies are fully implemented across the sample. Particularly, client segmentation was implemented 3 or more years ago in all institutions and 75% implemented the other strategies in the same time period.

However, the implementation of the two latter strategies is only relatively widespread (67.5% and 75% of institutions); as well as recent. Only 15% implemented scientific marketing tools 3 or more years ago, while 42.5% implemented CRM tools 3 or more years ago.

Regarding the second objective of this study, to verify the effectiveness of the implementation of these strategies to improve customer loyalty of Spanish financial institutions, we analyzed the evolution over the last five years of the “churn rate” for each one of these strategies, as indicated in section 3.

In order to evaluate the first three strategies, we analyzed exclusively the creation of client portfolios, as it is derived from the first two strategies, customer segmentation and differentiated marketing policies for each segment, so it can be considered that includes the analysis of these last.

The results obtained by studying the evolution of the churn rate in the last five years, after implementing the creation of client portfolios among financial institutions, are shown in Table 3.

Table 3: Development of client desertion rates as a result of implementation of client portfolios

% of Institutions	*Change in client desertion rates*				
Implementation of client portfolios	*Significantly reduced*	*Slightly reduced*	*No change*	*Slightly Increased*	*Significantly increased*
Not in use or future implementation	*0,0%*	*25,0%*	*75,0%*	*0,0%*	*0,0%*
Implemented 1-2 years ago	*0,0%*	*52,9%*	*47,1%*	*0,0%*	*0,0%*
Implemented 3 or more years ago	*0,0%*	*63,2%*	*36,8%*	*0,0%*	*0,0%*

According with Table 3, a higher percentage of financial institutions that implemented client portfolios for each segment one or two years ago, shown a slight decrease in their client desertion rates in comparison with those that did not (52,9% versus 25%). However, there is a better result in the entities that implemented this strategy 3 or more years ago, in comparison with those that did it 1 or 2 years ago, but with less differences than before (63,2% vs. 52,9%).

On the other hand, the results obtained by analyzing the evolution of the churn rate in the last five years, after implementing the multichannel strategy, are shown in Table 4.

Table 4: Development of client desertion rates as a result of implementation of multichannel strategy

% of Institutions	*Change in client desertion rates*				
Implementation of multichannel strategy	*Significantly reduced*	*Slightly reduced*	*No change*	*Slightly Increased*	*Significantly increased*
Not in use or future implementation	*0,0%*	*20,3%*	*79,7%*	*0,0%*	*0,0%*
Implemented 1-2 years ago	*0,0%*	*55,4%*	*45,6%*	*0,0%*	*0,0%*
Implemented 3 or more years ago	*0,0%*	*54,3%*	*46,7%*	*0,0%*	*0,0%*

As shown in the above Table 4, a high percentage of financial institutions that implemented multichannel strategy one or two years ago saw a slight decrease in their client desertion rates in comparison with those that did not (55,4% versus 20,3%). There is not a large difference between institutions that implemented these tools 1 or 2 years ago and those that implemented them 3 or more years ago (55.4% vs. 54.3%).

Moreover, by cross-listing the evolution of desertion rates with the implementation of scientific marketing tools, we obtain the results shown in Table 5.

Table 5: Development of client desertion rates as a result of implementation of scientific marketing tools

% of Institutions	*Change in client desertion rates*				
Implementation of scientific marketing tools	*Significantly reduced*	*Slightly reduced*	*No change*	*Slightly Increased*	*Significantly increased*
Not in use or future implementation	*0,0%*	*46,2%*	*53,8%*	*0,0%*	*0,0%*
Implemented 1-2 years ago	*0,0%*	*71,4%*	*28,6%*	*0,0%*	*0,0%*
Implemented 3 or more years ago	*0,0%*	*66,7%*	*33,3%*	*0,0%*	*0,0%*

Most financial institutions that implemented scientific marketing techniques one or two years ago saw a slight decrease in their client desertion rates in comparison with those that did not (71.4% versus 46.2%). There is not a large difference between institutions that implemented these tools 1 or 2 years ago and those that implemented them 3 or more years ago (71.4% vs. 66.7%).

Finally, the results obtained by considering the evolution of the "churn rate" in the last five years after implementing CRM tools, are shown in Table 6.

Table 6: Development of client desertion rates as a result of implementation of CRM tools

% of institutions	*Change in client desertion rates*				
Implementation of CRM tools	*Significantly reduced*	*Slightly reduced*	*No change*	*Slightly increased*	*Significantly increased*
Not in use or future implementation	*0,0%*	*30%*	*70%*	*0,0%*	*0,0%*
Implemented 1-2 years ago	*0,0%*	*61,5%*	*38,5%*	*0,0%*	*0,0%*
Implemented 3 or more years ago	*0,0%*	*64,7%*	*35,3%*	*0,0%*	*0,0%*

Client desertion rates are less likely to have diminished in financial institutions that implemented CRM tools 1 or 2 years ago, in comparison to those that did not (61.5% vs. 30%). Nevertheless, results are similar for those that implemented CRM tools 1 or 2 years and up to 5 years ago (61.5% vs. 64.7%).

5. Discussion and Conclusion

As shown in Table 2, the first four loyalty-development strategies have been implemented in 100% of the financial institutions in the sample. More than 70% of them did so over three years ago, particularly client segmentation (100%). However, the last two loyalty strategies (scientific marketing and CRM tools), are widespread within the financial industry, but not so much as the other loyalty-development strategies previously studied (32.5% of the participating financial institutions have not yet implemented scientific marketing tools, and 25% have not implemented CRM tools). This confirms the relevance that companies in this sector are giving to the customer loyalty processes, as indicated by Fainé and Tornabell (2001) and the report of the Conference Board (quoted in Daemon Quest, 2007).

Regarding the second goal of this paper, the effectiveness of these strategies within the context of loyalty development, we analyzed how the client desertion rate has evolved during the last 5 years according to the level of implementation of these tools.

Tables 3 to 6 show for each loyalty strategies studied in this research, that the evolution of the "churn rate" is always better to the group of entities that have adopted the strategy (with differences ranging between 25 and 30 percentage points according each strategy, among the institutions that have implemented it in the last two years and those have not yet adopted it). On the other hand, the effects of these improvements on desertion rates appear within the first two years of implementation and then reach a plateau, suggesting that in this sector, investments in improving customer loyalty, can be profitable in a short period of time.

Given these results, it would be valuable to further investigate the influence on customer loyalty of other characteristics of financial institutions. Among these, cultural elements such as orientation to the client or the market and leadership commitment with loyalty programs could shed more light on the practices of Spanish financial institutions. Another promising venue would be to study the implementation and effectiveness of customer-centric collaborative marketing, a strategy that is starting to be implemented by certain financial institutions.

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