Customer Loyalty Problems in Retail Banking

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Abstract: According to analyses of the most business consulting companies (KPMG, Capgemini, Deloitte, TowerGroup, etc.) customers are discontented with the retail banking experience. To achieve higher business growth, banks must increase customer loyalty by delivering a distinctive experience that combines the right mix of convenience, value and service and forges an emotional bond with consumers. Winners will be those that transform themselves into customer-centric enterprises by having a clear vision of what they want to achieve, fully aligning business processes and IT infrastructure to achieve those goals and engaging their employees in the process. The first step to do it is the identification of customer satisfaction. This paper intends to reveal its essential elements.

Keywords: customer loyalty, customer attitudes, retail banking

1 Forewords

Banks have not done a good job in focusing on the customer at least not in a way that has led to providing customers with distinctive experiences where their needs and preferences are recognized and consistently met and where loyalty emerges. Indeed, how customers feel about their banks can really be summarized as ambivalent. *2005 Deloitte Employee Survey* [6] found that only 19 percent of bank customers can be characterized as truly loyal to their bank. This proportion was the same in the USA and Europe. This ambivalence and weak loyalty is evident in a high degree of attrition. These are hardly the results of an industry that has built a loyal customer base. The main elements of the problem space seem to be the following [2]:

- Banks continue to struggle with loyalty programs: how to create them, how to measure loyalty, what rewards are appropriate.
- Measuring customer loyalty means quantifying customer attitudes and behaviors accurately, which can be difficult.
- Retail banks rarely have the competency and capability to accurately measure the profitability of their customers.

- A sophisticated loyalty program should be based on the concept of a fair value exchange between or among partners.
- Retail banks need to move away from product-centric loyalty programs toward those that reward an entire relationship.

Customer loyalty continues to be the bane of retail bankers' existence. Over the last decades bankers have experimented with a multitude of programs and tactics to strengthen customers' bonds of loyalty to their institutions. Throughout this period, perhaps the most frustrating challenges for retail bankers have been designing programs that have a discernible impact on loyalty, determining an appropriate level of rewards, and devising standards and metrics for measuring loyalty. Many retail banks have explored the path of least resistance, limiting their loyalty efforts to product-specific programs or simple date-based recognition programs.

If you examine the status of customer loyalty programs found within retail banks today, you will argue that retail bankers need to be more creative if loyalty between customers and the bank is to be a cornerstone of a strong, profitable relationship. Actions for designing effective loyalty programs are recommended.

2 Customer Loyalty

Mention the phrase, "customer loyalty program" to most bankers and their first thought is typically of product-oriented programs such as those that reward customers for using a particular product or service. Credit card programs that reward customers with airline miles are an obvious and ubiquitous example. And while such product-centric programs have been successful in promoting loyalty to products, they are not necessarily the most effective method of fostering customers' loyalty to their banks. Retail banks that desire to build relationships with customers that go beyond a single product need to focus on loyalty programs that are relationship oriented.

Today, retail banks struggle with customer loyalty; indeed, they often seem to have a classic "love/hate" relationship with their customers. Bankers profess to love their customers and want to engender unquestioning loyalty in them, but at the same time, they want to be able to "fire" customers, raise prices, or change basic agreements at will. Scratch the surface a bit, and it becomes clear that banks want to foster loyalty in "some" customers but not all. The distinction is important because it demonstrates the banking industry's assumption that not all customers are created equal and that valued customers (however the bank defines "valued") are worthy of a greater investment than those deemed less valuable.

This selectivity in regard to building loyalty is not unwise, but it presupposes that banks have the ability to discern the value of customers and negotiate with valued customers professionally, efficiently, and effectively. Given the rather simplistic calculations of customer profitability that exist in most retail banks, the idea of an equitable value exchange between two partners (customer and bank) is difficult for bankers to execute against. Hence the Janus-like behavior typical of retail banks: that is, lavish product-specific loyalty efforts on one hand and blunt notices of fee increases, branch closures, or changes in products and services on the other. As long as banks use a product focus as the cornerstone of their customer loyalty programs, any given customer enrolled in a customer loyalty program may be on the receiving end of correspondences that whipsaw between high esteem and cold disdain.

3 Customer Loyalty in Retail Banking

Customer loyalty is truly an amorphous concept for many bankers. Indeed, it can be argued that the reason so many bankers struggle with developing, deploying, and measuring customer loyalty programs is that there is little agreement among bankers as to what behaviors constitute customer loyalty and how best to encourage these behaviors. The lack of agreement among bankers as to what constitutes customer loyalty renders the discussion of customer loyalty programs cloudy and often unproductive. Further complicating the discussion is the fact that too many retail bankers still confuse customer loyalty with two distinct, yet closely related concepts: customer satisfaction and customer retention. The following definitions intend to clarify the interrelationships among these three concepts:

- *Customer Loyalty*: A customer's demonstration of faithful adherence to an institution (or merchant) despite the occasional error or indifferent service. As the definition implies, having entered into a business relationship with a financial services institution, the customer maintains and continues the relationship. In this view, customer loyalty is an attitude or behavior that customers explicitly vocalize or exhibit.
- *Customer Satisfaction*: A customer's perception that his or her needs, wishes, expectations, or desires with regard to products and service have been fulfilled. Again, it is an attitude or behavior that customers vocalize or exhibit. The implication is that the financial institution is consciously and proactively able to meet the myriad expectations of its many customers. Unfortunately, customer satisfaction is no guarantee of retention or loyalty.
- *Customer Retention*: The ability to hold on to customers over time. Unlike customer loyalty and customer satisfaction, which measure aspects of the relationship from the customer's perspective, customer retention is a direct measure of the institution's ability to maintain relationships with customers.

The tendency of bankers to use these three terms interchangeably only complicates the challenges of building effective customer loyalty programs. Even though increasing customer retention is not the same as having loyal customers, many bankers continue to act as though it is.

Retail banks are often guilty of mistaking customer inertia for loyalty. Correctly assigning customers to the four quadrants of behavior-attitude scale (*Truly Loyal, Accessible, Trapped, Higher Risk*) requires being able to discern the differences between the behaviors that customers demonstrate and their attitudes toward the bank. Customers that remain in a long-term relationship with a banking institution while holding the bank in relatively low esteem are merely trapped, not loyal. The challenge for the bank is in understanding the degrees of loyalty that exist among customers and designing loyalty programs that can address the loyalty gaps. In the interests of building healthy, long-term, mutually profitable, and satisfying relationships, bankers need to understand the connection between retention and satisfaction and how they interact to foster customer loyalty. Customer retention should not be used as a convenient proxy for customer loyalty.

4 The Challenges in Building Loyalty Programs

In today's world, so-called customer loyalty programs abound. Grocers, coffee shops, shoe stores, hotels, ice cream parlors, car washes, restaurants, and parking lots represent but a smattering of the merchants that regularly provide benefits to frequent and loyal consumers.

The programs offered by these merchants are typically simple, relying on the principle that patrons will receive a purchase or service either gratis or at a discount after meeting a predetermined quota of purchases.

Yet even in these relatively simple frequent-purchase programs merchants have considerable doubt as to the value of the rewards on offer. Consumers have many motivations for choosing a product or service provider: quality and variety of products and services, price, locational convenience, and quality of customer service all factor into why a consumer chooses to patronize a particular merchant at a particular moment. Merchants that institute frequent-buyer loyalty programs are never sure what has motivated the consumer's purchase. The reward may play a role, or it may represent nothing more than forgone revenue.

4.1 Bank Loyalty Programs

Against this societal backdrop of near ubiquitous loyalty programs, retail banks have long recognized the importance of building and strengthening customer loyalty. Despite a lack of clarity of objectives in banks' loyalty rewards programs, the programs do exist and typically fall into three categories:

- *Points programs* reward consumers for maintaining a product or service with the bank.
- *Relationship packages* bundle products and services together and provide discounts or special pricing to consumers.
- *Recognition programs* are commonly date based, acknowledging the longevity of customers' relationships with the bank or their personal milestones such as birthdays or anniversaries.

Such programs are simple and often inflexible in design in that they are designed for masses of customers and have very little customization capability. Programs that allow the consumer to redeem points from a catalog with a broad spectrum of consumer goods or services represent an attempt to inject some customization into bank loyalty programs.

Given the competition for loyalty awards that is common in the broader consumer market, it has often been difficult for banks to design programs and fund rewards that stand out not only from those of their banking competitors but from those of merchants as well. And so the challenges for banks in strengthening customer loyalty are actually threefold:

- how to construct loyalty programs that go beyond product loyalty to building relationships with customers,
- how to determine the appropriate combination of rewards for their customers, and
- how to measure the cause and effects of a loyalty program.

4.1.1 Program Structure

The primary challenge for retail bankers is determining the behaviors and attitudes that accurately reflect customer loyalty. Customer loyalty programs represent a long-term commitment on the part of the bank. Given that retail banks offer a multitude of products and services to consumers and spend considerable time and effort upselling and cross-selling the same, bankers should focus on the total relationship rather than on a single product or service. Communications with enrolled customers should reflect the tone and tenor of the loyalty program, regardless of the nature of the communication (e.g., notification of a branch closing, introduction of a new product).

4.1.2 Appropriate Rewards

Not only are customers not created equal, but also they perceive reward programs differently. What appeals to one consumer may have no value to another. Possible rewards should include discounts on bank products and services, interest rate bonuses, service level guarantees, and third-party reward programs. A broad array of rewards is necessary to ensure that all enrolled customers perceive value; a wide range of reward values ensures that the customer is rewarded based on the value of the total relationship.

4.1.3 Measurement

As noted earlier, customer loyalty should be measured in terms of both attitude and behavior. Within the banking industry, the emerging standard for defining customer loyalty involves the consumer's overall satisfaction, willingness to purchase additional products or services, and willingness to recommend the bank to others.

Retail banks vary significantly in the frequency with which they measure customer loyalty. Larger banks field surveys of their customers on a monthly basis but limit the surveys to representative samples among key customer segments. Smaller banks tend to field sample loyalty studies on a quarterly basis; attempting to measure attitudes and behaviors for all customers involved in loyalty programs every month would consume scarce research resources.

4.2 Building Loyalty into Retail Banking Relationships

Retail banks that are embarking upon or revamping a customer loyalty program should strongly consider incorporating a rewards system into their plans. Because retail banking is a relationship business, the institution needs to accept that a relationship is a two-way street and that a customer will maintain a relationship only if there is value in doing so. Fortunately, retail banks have a significant number of potential rewards they can use to promote and solidify customer loyalty.

Having a range of potential rewards to offer is critical because not all customers place the same value on all the characteristics of a banking relationship. Just as consumers patronize merchants for a variety of reasons, including quality and selection of products or services, price, location, and staff quality, customers choose their banks for a host of reasons.

To the extent that core processing systems and delivery channels allow, retail banks have a plethora of potential rewards they can offer to consumers as rewards for sustaining long-term, profitable relationships. Clearly, two integral aspects of negotiating value exchanges with customers are the ability to calculate the value of the total customer relationship and the ability to understand the real and perceived costs of each potential reward. Retail banks will be more successful in building loyal, profitable customer relationships when they pursue a value exchange approach to building loyalty programs.

4.3 Recommended Actions

Bankers must focus upon five actions in designing customer loyalty programs [2]:

- Determine which behaviors and attitudes are most indicative of loyalty, and then measure them regularly and track results according to customer segments.
- Keep product silos from undermining loyalty efforts by making sure that the whole relationship is acknowledged in all business units.
- Calculate the profit contribution for every customer involved in a loyalty program so that the value of customers can be correlated to the value of the rewards program.
- Reward customer loyalty according to the customers' priorities.
- Determine the risks and realities of working with third-party or partner loyalty programs.

Conclusions

While some retail banks have been successful in implementing loyalty programs based on products or services, the nature of retail banking is an argument for establishing relationship-based programs instead. In addition to providing assistance in meeting cross-selling goals, a relationship focus in loyalty programs can also preclude communication mistakes that result from one product group within the bank not knowing the true value of a customer's total relationship with the bank. This problem does exist in Hungary too.

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