International Journal of Science and Research (IJSR)
ISSN: 2319-7064
Impact Factor (2018): 7.426

Impact of Switching Costs on Reducing Customer Churn in Commercial Banks

Ropafadzo Mhizha[1], Dr Kudakwashe Zvitambo (PhD)[2]

[1]Lecturer in the Faculty of Commerce at Reformed Church University

[2]Senior Lecturer in the Faculty of Commerce at Reformed Church University

Abstract: ***In order to gain competitiveness in the increasingly aggressive market, commercial banks are known to have been focusingmore on deploying substantial resourceson marketing for survival. However, research amid all facets of customer relationship management increasingly suggests the importance of switching costs in retaining customers. This study examines the impact of switching costs in reducing customer churn. The study took interpretative paradigm stance which advocates qualitative approach. Forty business bank customers were interviewed. Themes and codes, using content analysis, were used to generalise the views of the participants. The study revealed that service, accessibility, technology and risk are the leadingfactors of switching costs that discourage customers from switching banks. Banks need to consider and manage these factors in their customer retention strategies. The study recommends that banks should not discourage switchingin a way perceivedburdensomebut employ more customer oriented strategies that satisfy and retain old customers whilst attracting new customers as well. However, switching costs may not be enough to reduce customer churn, other customer retention strategies still remain relevant.***

Keywords: Switching costs, customer churn, service marketing, customer retention

1. Introduction

Technological and innovative acceleration, along with increasing aggressive competition in the market, has led retaining customers becoming a very crucial task for enterprise survival. Among many facets of customer relationship management, switching costs has become a widely concern and a topical issuein various fields, namely, finance, economics, management and marketing. Porter (1980) opines that switching cost is a onetime cost that customers associate with the process of switching from one service provider to another.It arises when customers have to spend time, effort and money in order to change the service provider and the costincludes hassle, technology, accessibility, service and risk.

Empirical evidence from studies done on banks in developed countries indicates that higher switching costs may completely discourage the customers from switching. The customers may not change the service provider even though the competitor offers new products and low prices. Reichheld (1996) asserts that a five percent increase in customer loyalty produces an eighty five percent increase in profitability in the banking industry. Viewed in this light, it can be claimed that customer churn reduction is a vital issue for competence and continual existence of banks. However, though existing studies on switching costs has been widely upheld by the academia and business world, it lacks discussion about switching costs in the markets with economic challenges like Zimbabwe.

1.1. Customer churn in the banking sector

Customer churn also known as customer attrition has been evolving as one of the major challenges for many institutions including the banking sector.According to Wei and Chiu (2002) customer churn refers to a customer leaving a service provider, for another. The study denotescustomer churn as the movement of bank clients to competitor banks.A plethora of studies reveal that the banking sector exhibit low customer churn rates as compared to other sectors but the impact of losing a single customer is relatively high and impedes growth. Customers are usually loyal to a service provider for a very long time and habitually give all their financial business to one company (Hejazania and Kazemi, (2014). Churn management plays a pivotal role for commercial banks to enhance long term profitability.

1.2 Commercial Banks in Zimbabwe

The Zimbabwean banking sector is associated with ceaseless and intense competition among its players. The market share is shrinking due to economic challenges facing the country.Downsizing and closure of major companies is leading to increasing unemployment, hence reducing bankable customers. As a result, the thirteen registered commercial banks currently operating in Zimbabwe are competing for the remnant few clients. According to the 2018 monetary policy, these banks are financially sound with strong capital cushion that may be utilised in times of stress and compliant with the prudential liquidity ratio. The policy statement indicates that these banks are performing satisfactorily well and profitable despite the economic challenges in the country. They offer a wide variety of similar innovativebanking and financial products and services to personal and corporate customers. Switching costs seem to be prevalent due to information asymmetry but little is known about their effect on customer attrition. This paper therefore seeks to establish business clients' views in relation to switching costs and the impact of switching costs in reducing customer churn in commercial banks in Zimbabwe.

1.3 Research Objectives

1.3.1 To assess customer opinions on switching costs in commercial banks.

1.3.2 To examine the impact of switching costs on reducing customer churn in commercial banks.
1.3.3 To provide recommendations to banks on the management of customer churn

2. Literature Review

Based on literature survey, the conceptual framework guiding this study was developed. The modelbelow presents graphically the core aspects in the area studied.

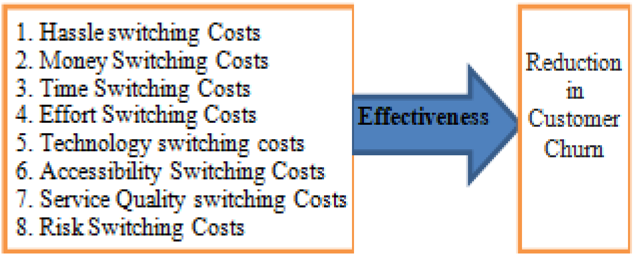

Figure 1: Conceptual Framework

Simple Google search reveals variousliteratures that exploreand provide a wide variety of views on switching costs.Theconcept of switching costs was initially promulgated by Porter (1980) and then research on the notiondeepened withstudies conducted by scholars in different fields revealing differentmeanings of switching costs. Switching costs can be understood as the costs that prohibit customers' desire to switch to competitors services (White and Yanamandram, 2007).

Switching costs are also defined by Burnham, Frels, and Mahajan (2003) as the onetime costs that customers associate with the process of switching from one provider to another. This definition elucidates that switching costs can vary but are only incurred once, at the time of switching supplier.

Burnham et al (2003) expounded that switching costs need not be "incurred immediately upon switching", and nor are they limited to objective or economic costs. This view was supported by Shiu, Zhou and Liu (2010) who assert that switching cots are also physical, emotional and time. They further argue that when customers switch to competitors, they mostly lose time, energy and money. The customerscan be excluded from certain benefits and opportunities due to being the member of the specific new organisation.

Jones, Mothersbaugh, and Beatty (2002) provide a different explanation of switching costs. They postulate that switching costs can be thought of as obstacles that hold customers in service relationships. However, their view differsthat of other scholars who believe that switching costs are also applicable even where relationships involve trading in products. Farrell and Klemperer (2007) state that a product has classic switching costs if a buyer will purchase it frequently and find it costly to switch from one seller to another. They expounded that switching costs also arise if a buyer will purchase follow-on products such as service and repair, and will find it costly to switch from the supplier of the original product. Gremler and Brown, (1996) determine that switching costs are greater for services than goods.

Klemperer (1987) postulates that switching costs include transaction costs, learning costs and contract costs. Burnham et al (2003) added on to the concept by dividing the complex variables into three dimensions which are procedural switching costs, financial switching costs and relational switching costs. Burnham's (2003) contributionswere also echoed byJones et al. (2007) who then suggested that switching costs are made up of procedural switching costs, lost benefit costs and social switching costs. Jones et al.,(2007) clarified that the procedural switching costs refer to the customer in the process of switching products or services, expectations of the time, energy or obstacles that may be encountered, the lost benefit costs refer to the potential loss of specific interests when customers shift one product or service to another product or service and the social switching costs refer to the relationship of the customers with existing suppliers and other consumers, while the networks built may have suffered.

Empirical evidencereveals that switching costs tend to lock-in customers, allowing monopolistic profits to be earned and reducing competition in the market. Hejazinia (2013) stipulates that if customers come across high switching costs, they usually prefer not to switch their service provider even though they are unsatisfied.

Klemperer (1987) establishes that "switching costs cause an allocative inefficiency". The effect of their existence means that competition between firms change from considering the needs of one customer in one period to considering those needs over time, or multiple periods whichforbids the movement of customers over a long period of time(Farrell & Klemperer, 2006).

Ongena and Smith (1997), in a discussion of the provision of loan facilities,propose that potential exists for a bank to extract monopoly rents from their customer due to the exclusive information the bank can observe. However, Anderson and Kaplan (1995) note that the extent of firms' monopoly power will rest upon how consumers react to the switching costs that apply.

Kim, Kliger and Vale (2001) support the existence and influence of switching costs in banking, in a study using data from the Norwegian banking market. They found that "switching costs in the market for bank loans are quite substantial and constitute a significant portion of the value of a marginal customer to the average firm". Thus, the above findings reveal switching costs as a model with variables which include various kinds of subjective and objective aspects mostly pertinent to service industries like the banking sector.

3. Research Methodology

The study took interpretative paradigm stance which advocates qualitative approach. Interpretative paradigm bases its argument on the fact that reality can be obtained from people's experiences. In this study, the reality can be generalised from customer's experiences on switching costs. The topic was tackled from the customers' point of view with business clients of commercial banks in Masvingo province as the target population. The population of interest consisted of clients who had an overall experience with the banking sector of at least a year. Convenience sampling method was used to select 40 participants from seven commercial banks in Masvingo.

Personal interviews were conducted on fourteen customers and the rest participated infocus group interviews done at business forums. An interview guide was used to solicit data through personal and focus group interviews.Results were then coded and analysed.

4. Findings and discussions

The study revealed that the majority of business clients have different opinions on switching costs. All respondents accepted that switching costs are inherent in their banking relationships. They stressed that it is difficult for them to move from one bank to anotherthough some could point out dissatisfaction with some of the services provided by their banks.Cited as the major reasons that hindered them from switching were as follows:

4.1 Service

Respondents indicated that they feared losing the service that they were currently receiving from their banks. Most of them had established long lasting relationships with staff that was enabling them to get some benefits through "know your customer" strategy applied by their banks which they were not sure of getting from competitor banks. This view was summed up by participant B who had this to say:

> *"A devil you know is better than a devil you don't know. It is difficult to break ties with these bank tellers whom we know already regardless of better products from other banks"* (Participant B)

4.2 Accessibility

In the focus group discussion participantsconcurred that they could not move from their banks due to the convenience of their banks. This assertion was further endorsed by views of the interviewed participants who argued that their banks had extensive branch networks and were close to their businesses that they could get any service they neededvery fast that facilitated easy transacting.

4.3 Technology

Face to face interviews and focus group discussions revealed that technological innovations hindered them from shifting banks specifically internet banking. They pointed out that this service provided by banks could allow them to do various banking activities without going to the bank and in a very short timeand were also associated with some technicalities which differ with banks. They indicated that they were unwilling to move to new banks and start afresh learning new systems. Participants revealed that changing bank has major implications on their time, money, risk and effort.

4.4 Risk

Findings also revealed that business clients in Zimbabwe felt insecure with some of the commercial banks especially approaching indigenous banks. They pointed out that though their services are more attractive than that of traditional and international banks, they had experienced closures of such banks that made them hesitant to move.

Results also showed that almost 50% of the respondents were multi-banked as a measure of managing the risk of losing out on opportunities such as relationships with staff, service, benefits and rewards. Respondents indicated that they decided not to lock in their funds in one particular bank due to economic instability experienced in the country which had resulted in the closure of some of the banks. They revealed that they could only shift part of their funds to any attractive alternative bank if the benefits it offers outweigh those of the current service provider.

4.5 Results on the impact of switching costs on customer churn in Zimbabwe

All the respondents agreed that switching costs have got great impact on reducing customer churn. However, they claimed that the effect of the different aspects of switching costs on reducing customer churn differs. Service, accessibility, technology and risk were the main switching cost factors mentioned to have more impact on reducing customer churn.

Respondentsunanimously claimed that they were dissatisfied with the service of their present banks and had no attractive alternatives. They indicated that they have been with their current banks because they had been offered long term facilities which other banks could not offer. This shows that such banks might be extracting monopoly fees through provision of loans from their clients as revealed by Ongena and Smith (1997). This also supports Kim etal (2001) who established that switching costs in the market for loans are quite substantial. These respondents were locked in their banking relationshipsfor very long periods despite dissatisfaction of high interest rates on loans they have been granted. They had to take the loans for the survival of their business entities and had no available options.

5. Conclusion and Recommendations

Findings have provided an understanding of the interplay between switching costs and customer churn.The study concludes that switching costs have substantial impact on reducing customer churn. There is a negative relationship between the two variables. The more the switching costs the less the customer attrition.The study recommends commercial banks in Zimbabweto consider the significance of switching costs in their customer retention strategies.

It can also be concluded that someswitching costs factors are more influential than others.Service, accessibility, technology and risk were the leading factors that hinder customers from shifting from one bank to the other. The study recommends banks tofocus more on managing theseprominent factors of switching costs since an appreciation of these influencing factors is vital to allow managers to direct efforts and resources in the most effective way to prevent customers' exit.

Though switching costs play a particularly substantial role in reducing customer churn, it has been revealed that they may not be enough to lock in customers in banking relationships if alternatives are perceived attractive. Banks are encouraged to establish and focus on more customer oriented strategies that satisfy their clients to create switching barriers that foster loyalty and lower churn rates.Switching costs must be managed carefully that when possible they should be reduced for potential customers but for existing customers they should be made high enough to discourage switching, but not so high that they are perceived burdensome.

The study concludes that banks could come up with new strategies to attract new customers from their competitorsthrough creation of an understanding and making use of information of what factors cause customers to switch banks. Switching costs are more effective strategy of reducing customer churn when there is low attractiveness of alternatives. The greater the knowledge the bank management has about the impact of switching costs on reducing customer churn, the greater the ability to develop appropriate strategies, to reduce or minimize customer switching.

6. Further Research

This research focussed on only two constructs in the banking sector among business clients in Zimbabwe. Further research is encouraged on switching costs in different markets and sectors. This research is also based on the customers 'point of view, there is need to get views of the commercial banks on this subject area.

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