

In the Name of God the Compassionate the  
Merciful

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# MASTER THESIS

## *Creating a model for customer loyalty in banking industry of Iran*

Supervisors:  
Dr. Mohammad.M. Sepehri

Dr. Lennart Persson

Prepared by:  
Golrou Abdollahi

Tarbiat Modares University Faculty of Engineering  
Department Industrial Engineering Luleå University of Technology

Department of Business Administration and Social Sciences  
Division of Industrial Marketing and E-Commerce

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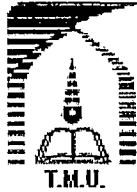
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ENGINEERING FACULTY

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The undersigned boards of examiners hereby, certify that

**Ms. Golrou Abdollahi**

Candidate for the degree of Master of Science in Marketing and E-commerce (The Joint Master Program between Luleå University of Technology and Tarbiat Modares University) has successfully defended this thesis entitled

**Creating a Model for customer loyalty in banking Industry of Iran**

The board considers the thesis acceptable in form and content; and that candidate through that oral examination, held on April, 15, 2007, demonstrated a satisfactory knowledge of the field covered by the thesis.



The Examining Body

Supervisor:

Dr. Sepehri

Supervisor:

Dr. Persson

Internal Examiner 1:

Dr. Chaharsooghi

Internal Examiner 2:

Dr. Aghdasi

Program Director:

Dr. Albadvi

External Examiner:

Dr. Salehi Sangari

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امضای استاد راهنما:

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*I dedicate this thesis,*

*with all my love and respect,*

*to my dear parents.*

## Table of content

Table of content.....	4
List of figures .....	6
List of tables.....	7
Abstract .....	8
Acknowledgement.....	9
Chapter 1 .....	10
1 Introduction.....	10
1.1 Background .....	10
1.2 Definitions.....	12
1.2.1 Who Is a Customer?.....	12
1.2.2 Customer churn .....	12
1.2.3 Loyalty .....	13
1.2.4 Retention .....	13
1.3 Customer relationship .....	13
1.4 Banking and loyalty .....	14
1.5 Research Area and Problem .....	16
1.6 Research Questions .....	17
1.7 Research Hypotheses .....	17
1.8 Steps in this research:.....	18
Chapter 2 .....	19
2 Literature Review.....	19
2.1 Customer's Bond.....	19
2.2 Loyalty .....	23
2.2.1 The difference between loyalty and retention.....	24
2.2.2 Customer Loyalty Objectives.....	26
2.2.3 Loyalty Programs and Its Benefits.....	28
2.2.4 Involvement of the Customer.....	31
2.2.5 Offensive and Defensive Strategies .....	33
2.3 Is It Proper To Retain Any Customer?.....	34
2.4 Perceived Quality .....	34
2.5 Customer Satisfaction .....	37
2.6 Switching cost.....	37
2.7 Habit.....	39
2.8 Choosing .....	40
2.9 Model .....	41
Chapter 3 .....	42
3 Methodology .....	42
3.1 Research purpose .....	43
3.2 Research Philosophy .....	44
3.3 Research Approach .....	45
3.4 Research Strategy.....	45
3.5 Time Horizon .....	47
3.6 Data Collection Method .....	47

3.6.1	Sampling .....	47
3.6.2	Collecting primary data using questionnaire.....	51
3.7	The credibility of the research finding .....	54
3.7.1	Reliability.....	54
3.7.2	Validity.....	55
Chapter 4	.....	56
4	Analyze .....	56
4.1	General Information .....	56
4.2	Analysis of the factors.....	57
4.2.1	Quality.....	57
4.2.2	Satisfaction.....	61
4.2.3	Switching Cost .....	62
4.2.4	Choosing .....	64
4.2.5	Habit.....	65
4.2.6	Loyalty .....	67
4.3	Correlation between factors .....	68
4.4	Each factor and its question's relationship.....	70
4.5	Factors relationship and suggestions.....	71
Chapter 5	.....	75
5	Conclusion .....	75
5.1	Answering the research questions and the hypothesis .....	76
5.2	Final model .....	78
5.3	Conclusion .....	80
5.4	Contribution .....	81
5.5	Limitations .....	81
5.6	Further research.....	81
Reference	.....	83
Appendix	.....	96

## List of figures

Figure 1:Internal attributes for customer loyalty intensity for consumer .....	25
Figure 2:Internal attributes for customer loyalty intensity for businesses .....	25
Figure 3:Bussines Strategy .....	33
Figure 4:Loyalty model (Beerli, Martin and Quintana, 2004) .....	41
Figure 5:The research process "onion" .....	43
Figure 6:Sampling Techniques .....	51
Figure 7:An illustration of the differences between validity and reliability .....	54
Figure 8:Factors Relations .....	74
Figure 9:Primary Hypotheses.....	77
Figure 10:Model Analysis Result .....	78

## List of tables

Table 1:Categories and dimensions of bond between customers and their banks .....	21
Table 2 :General information .....	57
Table 3:Perceived Quality Questions.....	58
Table 4:Perceived Quality Mean and Std. Deviation Result .....	59
Table 5:Tangible Quality Average Result.....	60
Table 6 :Intangible Quality Average Result.....	60
Table 7:Satisfaction Questions.....	61
Table 8: Satisfaction Mean and Std. Deviation.....	62
Table 9:Satisfaction Average Result.....	62
Table 10: Switching Cost Questions .....	63
Table 11 :Switching Cost Mean and Std. Deviation .....	63
Table 12: Switching Cost Average Result .....	64
Table 13 :Choosing Questions .....	64
Table 14:Choosing Mean and Std. Deviation .....	65
Table 15 :Choosing Average Result .....	65
Table 16 :Habit Questions.....	65
Table 17:Habit Mean and Std. Deviation.....	66
Table 18:Habit Average Result.....	66
Table 19:Loyalty Questions .....	67
Table 20:Loyalty Mean and Std. Deviation .....	67
Table 21:Loyalty Average Result .....	68
Table 22:Correlation Result .....	68
Table 23:Questions Result .....	70



## **Abstract**

The customer loyalty concept has received much attention from both academics and practitioners in different industry. Banking industry is also not excluded and because it has a highly interaction with the customers, getting familiar with this concept would be very important and helpful for managers in defining strategies. So this research attempts to find the customer loyalty factors and their relationships with banking industry in one of the developing countries in order to provide a model for this concept.

In order to do this a questionnaire is designed and validated ,then based on the data which were gained from the 400 respondents' answers to the designed questionnaire, the analysis is done on and the results and the relations are explained. Satisfaction, choosing, habit, tangible and intangible service quality and switching cost are the factors which influence the loyalty factor. To analyze the data, SPSS and LISREL software were used. It is hoped that this Master thesis would be helpful and interesting for both academics and practitioners.

**Keywords: CRM, Customer Loyalty Model, Banking**

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# Chapter 1

## 1 Introduction

*"Today, a customer loss is a customer gain for a competitor. With so many competitors, companies need to spend as much energy on retaining customers as they do on acquiring them. Businesses that understand churn and invest accordingly will need to invest less in placating dissatisfied customers and less in winning new ones to grow. Businesses that do not will find rivals with better retention machines rapidly overtaking them. Understanding how and why the churn occasion comes about will be critical."*

### 1.1 Background

The subject of customer retention, loyalty, and churn is receiving much-needed attention in many industries. (Matt Hasan, 2001). This is evident from the number of "customer intimacy" initiatives that are either under way or being considered in a variety of companies. Top-level decision makers are making substantial investments in developing business strategies, plans, programs and infrastructure to address the "needs" and

“preferences” of customers, as opposed to deciding for them what they want and cajoling or coercing them into making purchase decisions accordingly. One manifestation of this change is the ushering in of “relationship marketing,” where individual customers (or small groups) are dealt with differentially and the objective is to build a lasting relationship with them. (Matt Hasan, 2001) This is very different from the old paradigm of “transaction marketing,” where the focus is predominantly on making the current sale. The customer market is one of the many different markets that businesses need to consider. Businesses traditionally employed transaction marketing, i.e. marketing through 4Ps: transactions of product, price, promotion, and place. However, over the past two decades, businesses across all sectors have increasingly moved towards relationships, networks and interactions.

This shift in business thinking has been necessitated in no small measure by the commoditization of offerings and the intensification of competition in many industries, rendering ownership of the customer relationship, the most critical business success factor. Examples of these types of market dynamics are in long distance telecommunications as well as the credit card, retail banking, insurance, food and beverage industries, cellular phone service, cable TV, information services, and health care, banking service.

This customer-centric realization on the part of key decision makers is definitely a move in the right direction. Anecdotal data from several industries indicate the importance that business decision makers now place on customer retention, loyalty and churn.

The CRM approach to marketing has gained much currency in recent years, seeking to establish closer relationships and interactions between a business and its most important customers. CRM-oriented businesses market their products and services through relationships and interactions with multiple markets, most notably the customer market, often taking advantage of IT-based interactivity. This is why relationship marketing is termed “customer relationship management” when it emphasizes the customer market in particular.

Many researchers consider CRM as a new paradigm in marketing. The concept of “paradigm” has been defined as “a set of assumptions about the social world, and about what constitute proper techniques and topics for inquiry”. Much of the marketing literature has regarded CRM as representing a paradigm shift in marketing thought. CRM is

reshaping the marketing landscape. Customer Relationship Management has overtaken the market and it is revolutionizing marketing and reshaping entire business models.

According to Zineldin (2005), it would seem that the discussion is much similar to the one in the 1990s on whether relationship marketing constituted a new paradigm or not. In this respect, relationship marketing is defined as being about “establishing, developing, and maintaining successful relational exchanges”. Exchanges would take place between the business and important markets, including the customer market (Christopher et al., 1991).

## **1.2 Definitions**

### **1.2.1 Who Is a Customer?**

Customer can be defined in different ways, for example Sara Gustafson and Erica Lundgren (2005) described “a customer” as below:

A Customer is the most important person ever in this office . . . in person or by mail.

A Customer is not dependent on us . . . we are dependent on him.

A Customer is not an interruption of our work . . . he is the purpose of it. We are not doing a favor by serving him . . . he is doing us a favor by giving us the opportunity to do so.

A Customer is not someone to argue or match wits with. Nobody ever won an argument with a customer.

A Customer is a person who brings us his wants. It is our job to handle them profitably to him and to ourselves.

### **1.2.2 Customer churn**

Customer churn is the tendency for customer to move from one competitive provider to another (Michael Fox and Missy Poje, 2002).

### **1.2.3 Loyalty**

Loyalty has to be defined as an internal intensity of customers towards sticking with or switching from their current supplier—an inherent value. Customer loyalty is when a customer remains as a client of original supplier even if a competitor proposes more advantageous conditions.

### **1.2.4 Retention**

Retention is the outcome or the event that customers are retained with their current provider.

## **1.3 Customer relationship**

Relationship management, however, emphasizes the organization of marketing activities around cross-functional processes as opposed to organizational functions or departments. This results in a stronger link between the internal processes and the needs of customers, and results in higher levels of customer satisfaction. CRM evolved from business concepts and processes such as relationship marketing and the increased emphasis on improved customer retention through the effective management of customer relationships. Both RM and CRM emphasize that customer retention affects company profitability in that it is more efficient to maintain an existing relationship with a customer than create a new one (Zineldin, 2000, 2005) cited by (Payne et al., 1999; Reichheld, 1996).

Several studies have examined the importance for a business of retaining its customers in great depth, with evidence suggesting that retention leads to increase market share and eventually greater profits. Marketing tools that businesses can employ for retaining customers may, therefore, provide for a competitive advantage. For example, tools may contribute to product and service differentiation, as well as to create barriers for customers switching to other products and services.

During the 1990s, many organizations and consumers experienced great movements and actions. Some key environmental factors provided the setting whereby companies changed their attention and orientation toward marketing and the consumer.

Companies have recognized the fact that they must change and restructure their way of establishing and maintaining business relationships. For example, many manufacturers discovered, or more adequately, re-discovered that close relationship with customers is not valuable with constantly changing technology and increasing global competition.

Today's businesses are facing fierce and aggressive competition while operating in both domestic and global markets. Most managers and marketers would of course agree that establishing long-term business relationships is about development and survival. According to Lewis (1991), the world has never been so interdependent. All trends point to cooperation as a fundamental, growing force in business.

Marketing is also about how to integrate the customer into the design of the products/services and how to design a systematic process for the interaction that will create substance in relationships. In a competitive world, companies have to work hard to gain any added value. They have to work with their customers to discover the new ways for running the business more efficiently for themselves and more effectively for the customers.

#### **1.4 Banking and loyalty**

During the past decade, the financial service sector has undergone drastic changes, resulting in a market place which is characterized by intense competition, little growth in primary demand and increased deregulation. (Bloemer, Ruyter, Peeters, 1998) In the new market place, the occurrence of committed and often inherited relationships between a customer and his or her bank is becoming increasingly scarce (Levesque and McDougall, 1996). Several strategies have been attempted to retain customers. In order to increase customer loyalty, many banks have introduced innovative products and services (Meidan, 1996). However, as such innovations are frequently followed by similar charges; it has been argued that a more viable approach for banks is to focus on less tangible and less easy-to-imitate determinants of customer loyalty such as customer evaluative judgements like service quality and satisfaction (Worcester, 1997; Yavas and Shemwell, 1996).

Banking has traditionally operated in a relatively stable environment for decades. However, today the industry is facing a dramatically aggressive competition in a new

deregulated environment. The net result of the recent competition and legislation is that traditional banks have lost a substantial proportion of their domestic business to essentially non-bank competition. Competition will undoubtedly continue to be a more significant factor. Finding a place in this heating sun becomes vital to the long-range profitability and ultimate survival of the bank. Those banks that are not considering the new atmosphere to build and protect their competitive position will likely become victims of that heating sun. (Zineldin, 2006)

Banks begin to realize that no bank can offer all products and be the best/leading bank for all customers. They are forced to find a new basis for competition and they have to improve the quality of their own products/services (prodserv) (Zineldin, 1996; Olsen, 1992). A bank has to create the customer relationship that delivers value beyond the provided by the core product. This involves added tangible and intangible elements to the core products, thus creating and enhancing the “product surrounding”.

Positioning is an attempt to distinguish the bank from its competitors along real dimensions in order to be the most preferred bank for a certain market segment or in other words, if a bank can position itself favorably within a particular marketplace, relative to competitors, that bank is a competitive one. Competitiveness means that a bank, in terms of its competitive position, its management and marketing strategies, its use of information technology, the quality of its products/services and its ability of managing long term customer relationship must be increasingly responsive to the market consideration and customer orientation.

The increasing importance of relational marketing in recent years, particularly in the servicing and manufacturing industries, such as banks, has been accompanied by a bundle of works on customer loyalty. Several authors emphasize the positive relationship existing between customer loyalty and business performance (Beerli et al., 2004; Reichheld and Sasser, 1990).

Loyal customers not only increase the value of the business, but also enable it to maintain the costs lower than those associated with attracting new customers (Beerli et al., 2004).

Generally, loyalty has been and continues to be defined as repeat purchasing frequency or the relative volume of the same-brand purchasing. Many definitions in the



literature suffer from the problem that they record what the consumer does and none taps into the psychological meaning of loyalty (Oliver, 1999).

By the above introduction to customer relationship, loyalty and bank, now it is time to have a brief look at what is going to be in this research.

## 1.5 Research Area and Problem

Iranian banking industry is made of different banks which are in three main categories:

- Commercial government-owned banks
- Private banks
- Specialized government banks

In the first category, the banks are owned by government and they do the commercial tasks which are described in the Iranian banking rules. The second category includes the banks which obey the Iranian banking rules but they are not owned by the government. These banks are established by a person or a group of people under the control and supervision of the central bank of Iran. These banks do the banking tasks which are described in the banking rules of Iran. The last category is specialized government banks which are the same as the first group but their activities are more focused on some special tasks, like agriculture, house and buildings, etc.

Also there is one more category which does not consist the ordinary banks. It is a monetary institute which does some limited tasks and activities and is named near-banks. In this research only the main banking categories were considered. All of these banks have some main tasks like credit activities, monetary activities such as opening different accounts, payment activities...

In this environment naturally there are some customers who are using the banking services, and because of the similarity of the offered services by different banks, I consider the customers similar to each other.

In this competitive environment each company or bank wants to absorb the customers. This can be done both by maintenance or having new ones. So main and clever ones understand that they should work on the customer loyalty.

In this research I tried to find the main factors of the customer loyalty in banking industry of Iran in order to help this key industry to have a wider look for supporting their customers and finally having more loyal ones.

## 1.6 Research Questions

The answer to the following questions will together provide us the possibility to reach the objective of this research.

- Can a model for customer loyalty in banking industry of Iran be specified?
- What factors influence the customer loyalty in banking industry in Iran?
- What are the relationships between the factors?

In order to answer to the research questions I defined some more detailed questions such as:

- Does customer satisfaction influence the loyalty of the customer?
- Does customer habit influence the loyalty of the customer?
- Does switching cost influence the loyalty of the customer?
- Does perceived quality influence the loyalty of the customer?
- Does choosing influence the loyalty of the customer?

## 1.7 Research Hypotheses

This research attempts to determine the factors which affect customer loyalty in banking in order to make a loyalty model for Iranian banking customers.

Therefore the following hypotheses are formulated:

H1: Choosing influences the loyalty

H2: Satisfaction influences the loyalty

H3: Switching cost influences the loyalty

H4: Habit influences the loyalty

H5: Perceived Quality influences the loyalty

## **1.8 Steps in this research:**

In the second chapter we have a look on what the previous studies have done on this topic. In the third chapter we have a look at the methodology of this research. In the fourth chapter the analysis of the findings will be discussed, and then in chapter 5 we can have a conclusion on what we studied. Also the final model of customer loyalty in banking industry in Iran will be presented. Then some comments for further researches will be given in the last chapter.

## **Chapter 2**

### **2 Literature Review**

*“...Ellie Trubik and Malcolm Smith in 2000 mentioned in their research that four attributes are suggested to help identify leaving customers in banking industry: 1 the customers had one product; 2 their major channel was a branch; 3 they had no fee exemption; 4 they were on their third month with the bank.”*

#### **2.1 Customer's Bond**

According to Berry and Parasuraman's (1991) conception of customers-seller bond has three levels: level 1 – Financial bond, which refers to a bond that is tied by price; level 2 – Social bond, which refers to a bond that is formed upon a friendship between a customer and service staff; and level 3 – Structural bond, which refers to a bond that is formed as a result of joint investment by both the seller and the buyer. In addition to price,