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Abstract

In this paper, we present a conceptual framework that helps to assess the impacts of Information Technology on customer loyalty in retail banking. We begin by identifying the antecedents of customer loyalty. We then suggest how Electronic Banking impacts these antecedents. Based on our analysis, we suggest that although Electronic Banking may increase customer satisfaction, it may, nevertheless, lead to lower levels of customer loyalty. We believe that this may occur because Electronic Banking reduces the amount of customer-bank personnel face-to-face interaction, which will negatively affect banks' ability to generate trust.

Introduction

Today's banking industry is increasingly turbulent and competitive. For instance, several international "traditional" banks (e.g., Hong Kong Bank, Banque de Paris) as well as some virtual banks (e.g., ING, First Virtual Bank, City Bank) have entered the North American market in recent years. In addition, numerous firms are now competing with banks by offering financial products and services (e.g., Sears' credit card, GM's auto financing, Merril Lynch investments, Fidelity's and Investors' mutual funds). To compete in such an environment, banks adopted a relationship banking strategy where the main focus is on trying to instill, build, and maintain client loyalty through customer segmentation, product differentiation, cross-selling, and product bundles. Further, loyalty has been shown to significantly affect profit for several reasons: expected profit from a customer significantly increase over time as customers become accustomed to using a service, cross-selling works better with long-time customers, and acquiring new customer entails significant costs (Reichheld and Sasser, 1990).

In parallel, in an effort to offer better services and to reduce operating costs, banks are investing important amounts of money into customer-oriented information technology (IT) better known as Electronic Banking. For instance, in 1998, US banks invested $18 billion (US) in IT. There were more than 15,000 ATMs in Canada in 1999, compared to 6894 in 1990. Aside from ATMs, Electronic Banking also includes 'Direct Deposit' which enables customers to authorize specific habitual deposits to their checking and savings accounts (e.g., paychecks and social security checks), 'Pay-by-Phone Systems' that allow customers to instruct their financial institution by telephone to pay bills and transfer funds between accounts, and 'Personal Computer Banking' which provides customers with the capability to conduct several transactions electronically (e.g., view account balances, transfer funds between accounts, bill payment) with the help of a PC (IFG Inc., 2000). The end result is that more people use self-service IT in retail banking and fewer go to branches, where the bank can establish and nurture a personal contact with clients. While in 1995, 56% of retail transactions were made in branches, they accounted for less than 40% in 1999, a decrease of almost 30%. Consequently, a key question arises: What is the impact of Electronic Banking on customer loyalty? This paper addresses the issue.

In the following sections, we define loyalty and identify its antecedents. Furthermore, we suggest how Electronic Banking affects these antecedents and propose a conceptual model (Figure 1.) of the impacts of Electronic Banking on loyalty. Our model suggests that Electronic Banking services can lead to greater customer satisfaction but may, nevertheless, also have adverse effects on loyalty. Accordingly, we postulate the following global proposition:

> P1: Electronic Banking will be negatively associated with customer loyalty toward banks.

We suggest that this may occur because (a) the more customers rely on Electronic Banking the less they interact with tellers and managers, and (b) banks may implement Electronic Banking as a direct substitute for traditional banking practices, thus lowering the number of tellers available at branches or closing down branches completely. Both situations imply that customers' repeat interaction with front-line personnel may be intrinsic in establishing customer loyalty in retail banking. The first condition described above may be unavoidable in that it is symptomatic of the Banking industry's move toward Electronic Banking. The second stems from a bank's strategy and may be indicative of banks undervaluing the importance of bank personnel in helping to develop customer trust and confidence.

Loyalty

What is Customer Loyalty?

Organizational benefits of customer loyalty are said to include: (a) post-purchase consumer communications (e.g., positive word of mouth) (Reichheld, 1996), (b) decreased search motivation (Holbrook, 1978), (c) resistance to counter-persuasion (Wood, 1982), (d) increased frequency of purchase (Reichheld and Sasser, 1990), (e) lower price sensitivity (Krishnamurthi and Raj, 1991), and (f) for companies with loyal customers, it translates into having more time to respond to competitors' actions (Aaker, 1991). In retail banking, the benefits associated with increasing customer retention include (a) a three-year increase in average customer lifetime when customer retention increases by 5%, (b) an important reduction in defection rates, and (c) an increase in account usage (Council of Financial Competition, 1995).

From an IS research perspective, the importance of recognizing that the implementation of IT may impact customer loyalty, and subsequently, affect organizational performance has been overlooked in previous IT-Organizational Performance research. Financial performance measures may, in fact, be directly affected by customer satisfaction and the company's ability to foster long-term relationships with its customers (Reichheld and Sasser, 1990; Rust and Zahorik, 1993). Positive correlations have been reported between customer variables (i.e., repurchase intention, perceived quality, perceived value, and loyalty) and financial performance measures (i.e., ROA, market-to-book ratio, and price-earnings ratio) (Ittner and Larcker, 1996). In particular, the link between customer loyalty and bank performance is revealed in an analysis conducted by the Cumberland Bank (USA). An investigation of their top 5% customer base indicated that a customer retention rate increase of 5% resulted in a profitability increase of 24% (Murphy, 1996).

Despite these reported benefits, a review of Marketing literature indicates that there has long been disagreement about what represents customer loyalty and how it should be measured. Historically, assessing customer loyalty to a seller, manufacturer, or service provider has often consisted of using either actual purchase behavior or customer self-reports. It has been suggested that behavioral data is easier and less costly to collect (Dekimpe, Steenkamp, Mellens, and Abeele, 1990) and that it may be superior to attitudinal data because it represents how customers actually behave instead of how they merely feel (Colombo and Morrison, 1989). Nonetheless, behavioral measures are not problem-free. By simply observing overt behavior one cannot differentiate whether a customer's loyalty is true or spurious (Zabava Ford, 1998). Consequently, behavioral definitions of loyalty have been criticized as focusing solely on outcomes (Jacoby and Chestnut, 1978) because they fail to identify what important factors underlie the actual behavior.

As a result, several authors have suggested that loyalty be considered as a composite of both attitude and behavior (Day, 1969). Recent conceptual work construes loyalty as the relationship between attitude towards the target relative to available alternatives and patronage behavior (Dick and Basu, 1994). Given that repeat patronage may occur without the existence of prior positive attitude, or that, strong relative attitude may not necessarily be accompanied by repeat patronage, this conceptual model suggests that different types of customer loyalty may ensue. Thus, 'true loyalty' arises when strong relative attitudes are associated with high levels of repeat patronage. 'Spurious loyalty', on the other hand, emerges when the customer perceives little difference between alternatives (i.e., relative attitude is low) but purchases one brand more consistently than others. 'Latent loyalty' is categorized by high relative attitude and low repeat patronage. Such a condition may occur when situational and social factors intervene strongly and counter the effects of relative attitude. Finally, under conditions of 'no loyalty' both relative attitude and repeat purchase behavior are low. Importantly, this conceptualization of loyalty includes cognitive, affective, and conative factors as antecedents to relative attitude and recognizes that situational factors mediate the relationship between relative attitude and behavior.

The Benefits of Electronic Banking

Information Technology such as ATMs, telephone banking, and Web-Banking can be beneficial to both the financial service provider and its customers. For the latter, these information technologies allow to pay bills, verify account balances, and obtain information about loans and mortgages without having to physically travel to the nearest branch. It is, therefore, not surprising that customer interest seems to be considerable; a study conducted at Georgia Tech found that 50% of respondents were interested in opening an Internet-based account (Riggins, 1998). Moreover, the Gartner Group's Dataquest unit estimates that, by the end of 2001, 18.3 million U.S. households will be using PCs for personal banking (ABA Banking Journal, July 1999, p.36). Electronic-Banking also offers customers more choice when selecting financial institutions (i.e., by reducing search costs) and rids the customer of situational constraints such as having to do business with a branch that is in proximity to either his/her work or home because no other banks have established branches nearby.

For banks, the added convenience and flexibility provided to customers may translate into increased levels of customer satisfaction, which has been shown to be positively related to loyalty (Kasper, 1988). Also, more tangible benefits can be obtained. Although Electronic Banking has contributed in creating a business environment that is increasingly turbulent and competitive, it has enabled banks to save on operating costs by reducing the number of 'brick and mortar' locations necessary to service customer needs adequately. Moreover, the Internet's ubiquity and low access cost allow banks to market their offerings both domestically and globally to a potential customer base that is reported to be increasing daily.

The Impact of Electronic Banking on Loyalty

Situational Factors: Moderators

The conceptual model of loyalty discussed in the previous section suggests that loyalty is the relationship between relative attitude and behavior (Dick and Basu, 1994). Situational factors are believed to affect this relationship and explain why customers may or may not behave accordingly to their attitudinal dispositions (i.e., why some customers continue patronizing institutions for which they harbor weak attitudes). Traditionally, for financial service providers, the location of branches has been the most important factor in distributing their services effectively (Riggins, 1998). Proximity to home/work and operating hours have been identified as being central reasons dictating what bank customers choose (Rust and Zahorik, 1993). Because Electronic Banking reduces switching costs (i.e., spatial and temporal constraints), it seems that Electronic Banking should entail customers to behave more consistently with their relative attitudes. In other words, assuming that relative attitude does not vary, Electronic Banking should allow customers to do business with the bank that they feel more positively about. This suggests that, although Electronic Banking may cause a bank to loose several customers to competitors, it will enable it to attract those customers who have a propensity to become truly loyal. In other words, the moderating effect of various situational factors on the relationship between relative attitude and patronage behavior will be less significant for banks that have provided customers with Electronic Banking capabilities than those that have not. We, therefore, hypothesize the following:

> H1: Electronic Banking use will be negatively related to perceived spatial and temporal constraints (i.e., limited operating hours, distance).

Antecedents to Loyalty

According to the arguments presented in the previous section, Electronic Banking should allow customers who exhibit latent loyalty to become truly loyal by switching to the bank of their choice. In other words, customers may start behaving more consistently with their positive attitudinal disposition. However, it is questionable whether attitudinal dispositions will remain unaffected. In fact, we suggest that Electronic Banking impacts customers' relative attitude towards a bank by intervening on several antecedents. Figure 1 depicts how we have conceptualized the effects of Electronic Banking on loyalty. We propose that Electronic Banking may have a positive effect on customer satisfaction toward banks, but may nevertheless, strongly impede the formation of personal relationships between bank representatives and customers due to the lower frequency of face-to-face interaction. Subsequently, it may be detrimental to the customer's ability to differentiate between alternative banks. Because 'true loyalty' is characterized by high relative attitude and high patronage behavior (Dick and Basu, 1994), 'true loyalty' should diminish as Electronic Banking may cause relative attitude to become lower.

Customer Satisfaction

Satisfaction has emerged as a popular Marketing construct to gauge customers' affect-based proclivity. It is considered to be an important antecedent to loyalty (Dick and Basu, 1994). However, although the link between satisfaction and loyalty exists, it is not straightforward. The assumption that a strong relationship exists between these two constructs in retail banking is questionable. "There is considerable evidence that companies with measured customer satisfaction levels as high as 90% can experience more than 20% turnover in their customer accounts" (Lowenstein, 1997, p.3). Moreover, the results of a study indicating that 90% of customers that switched banks were, in fact, satisfied with their original bank (Reichheld and Aspinwall, 1993) further illustrates the intricacy of the relationship and strongly discourages against considering loyalty as an unconditional consequence of customer satisfaction. And yet, measuring customer satisfaction levels has become mainstream in the banking industry.

Although satisfied customers do not necessarily become loyal customers, satisfaction has been shown to positively impact loyalty in various retail contexts (Newman and Werbel, 1973). Therefore, it becomes important to identify what service characteristics lead to satisfaction in retail banking and how Electronic Banking may affect these factors.

In a study that looked at courteous behaviors (e.g., smiles, touches, forward leans, eye contact) of bank tellers and its effect on customer satisfaction, results did not demonstrate a significant relationship between the tellers' non-verbal behavior and customer satisfaction with the teller, the transaction, or the bank (Ketrow, 1991). In fact, the results of the study suggested that speed of service might be more important to attain customer satisfaction. Although the influence of efficiency related factors (i.e., ease of access to and the quick and efficient delivery of financial information) seem to strongly overshadow the effects of courteous service, the latter should not be dismissed as completely unimportant in generating customer satisfaction. The results of one study demonstrated that, although smiling and eye contact had no significant impact on customer satisfaction, the tellers' use of greetings was significantly related to satisfaction (Brown and Sulzer-Azaroff, 1994). Recent technological developments allow customers to personalize the informational content delivered through a bank's web page. With the use of 'cookies' (i.e., small updateable files deposited on the user's hard disk), the greeting delivered by the web page can contain the customer's name. Consequently, we believe that Electronic Banking should positively impact customer satisfaction.

Indeed, the use of Information Technology (e.g., using the bank's Web-site allows customers to verify their account balances) provides customers with several advantages, such as, more flexible business hours, greater convenience by not having to physically travel to a local branch, and a reduction in waiting time. Waiting to be served may cause dissatisfaction when waiting time is perceived to be excessive. In fact, research has shown that the number of tellers available at busy times is an important factor to customers' evaluation of the quality of service (Rust and Zahorik, 1993). Because Electronic Banking allows customers to conduct several tasks without the assistance of tellers, the potential of customer dissatisfaction due to excessive waiting is reduced. We, therefore, propose that:

H2: Customer satisfaction will be positively associated with the use of Electronic Banking.

Trust

It has been suggested that 'bonds' develop that explain the persistence of long-term relationships between customers and banks (Holmlund and Kock, 1996). Aside from legal and economic bonds, which arise when the customer enters into contractual agreements with the bank (e.g., borrowing money), "social bonds between the customer and the management or other employees in the bank can also be strong, because of trust, and knowledge developed during both formal and informal face-to-face contacts" (p. 290).

Trust has been linked to loyalty. For instance, it seems that a negative relationship exists between trust and the customer's propensity to leave (Morgan and Hunt, 1994). Moreover, trust was found to play an important role in anticipated future interaction (Doney and Cannon, 1997) and is a determinant in expected relationship continuity (Anderson and Weitz, 1989). Trust leads to commitment in a relationship (Dwyer, Schurr, and Oh, 1987) and commitment has also been identified as directly contributing to loyalty (Ford, 1982). When customers and salespeople have an interpersonal relationship, trust and commitment to the salesperson directly impact the customers' intentions to purchase (Macintosh and Lockshin, 1997).

Trust, and subsequently commitment, are said to develop over time as cumulative processes as one person amasses knowledge about another person through experience (Lewicki and Bunker, 1995; Ford, 1982). Trust is defined as "the willingness to rely on an exchange partner in whom one has confidence" (Ganesan, 1994, p. 3). Trust can be exhibited towards employees and towards the company itself. One study found that selected suppliers and their salespeople were more trusted than unselected suppliers (Doney and Cannon, 1997). However, because employees are at the front line of customer service, trust in the salesperson is believed to be a necessary condition for creating trust in the company (Chow and Holden, 1997). Nonetheless, it seems that banks have traditionally failed to recognize the importance of their branch personnel in helping to establish customer trust. Survey results reported in the February 1999 issue of the ABA Banking Journal show that only 4.4% of the banks surveyed indicated that they used incentives to encourage employees to work hard to hold onto existing customers.

The services provided by banks range from low-involvement services such as opening savings or checking accounts to high-involvement services such as long-term savings and investment products (i.e., financial advising). The importance of employees in establishing customer trust may be especially significant in the delivery of the latter type of services. When seeking financial advice, customers place themselves in a vulnerable position due to the long-term nature of savings and investment products and because of imperfect and asymmetric information. Consequently, because assessing advice quality is very difficult for customers, the establishment of trust and confidence plays a crucial role when providing financial advice (Palmer and Bejou, 1994).

Research indicates that the factors that influence the development of trust in salespeople include likeability, similarity, and frequency of contact (Doney and Cannon, 1997). Likewise, a sense of familiarity with the service provider has been shown to play an important role in the customer's assessment of the service experience (Czepiel, 1990). Not only does Electronic Banking directly limit the amount of personal interaction between customers and bank personnel, it is also unlikely that customers that rely on electronic channels (e.g., email) to communicate with their bank will repeatedly interact with the same bank personnel each time. In contrast, customers' frequent direct contact with branch personnel leads to familiarity. "In most industries, the cost benefits of loyalty spiral directly from the way long-term customers and long-term employees interact and learn from one another" (Reichheld, 1993, p. 46). Studies that have collected data directly from customers rather than service providers offer a more accurate picture of what actual service characteristics lead to higher quality assessments in retail banking. Results from one such study (Stafford, 1994) identified an important factor, which they named 'continuity and comfort'. This factor included such items as knowing the tellers/employees of the bank. In fact, this factor scored higher than the availability of ATMs (in terms of mean).

Research findings have shown that computer-mediated communication (CMC) was less personal and socio-emotional than face-to-face exchanges (Hiltz, Johnson, and

Turoff, 1986). Because many of the cues that are present during face-to-face communication are not available in CMC, differences in affective and relational patterns may evolve. According to Information Richness Theory (Daft and Lengel, 1986), four factors influence richness: 1) the medium's capability to transmit multiple cues (i.e., gestures, vocal inflection, etc.), 2) Immediacy of feedback, 3) Language variety, and 4) the personal focus of the medium. As a result, face-to-face communication is considered to be the richest. Likewise, Social-Presence Theory suggests that 'social presence', which is defined as "the degree of salience of another person in an interaction and the consequent salience of an interpersonal relationship" (Walther and Burgoon, 1992, p. 52) may be very low in CMC when compared to face-to-face communication. During face-to-face exchanges, participants can use both verbal and non-verbal cues and feedback is instantaneous as opposed to, for instance, e-mail. "Face-to-face communication is personal in nature, because of the physical presence of the interactant and immediate exchange of verbal and nonverbal cues" (Westmeyer, DiCioccio, and Rubin, 1998, p. 44). During CMC there are fewer spontaneous questions and more formal expression (Kiesler, Zubrow, Moses, and Geller, 1985). "When social cues are missing, communication becomes impersonal. Thus, when message receivers feel that a person (rather than a medium) is actually delivering the message, the channel has social presence" (Westmeyer et al., 1998, p. 30). Bonding especially develops during face-to-face interactions (Czepiel, 1990). Accordingly, "if creating an interpersonal atmosphere is important, the medium should stress social presence" (Westmeyer et al., 1998, p. 31). We suggest that 'richness' and the degree of 'social presence' of the communication channel used will affect the bank's ability to create trusting relationships between its customers and its employees. Therefore, as CMC increasingly replaces traditional face-to-face exchanges (partly because the breadth of financial services provided electronically is increasing and because banks may adopt electronic commerce strategies that further limit customers' abilities to repeatedly interact with specific bank personnel), we suggest that this should lead to a negative effect on bank trust and, consequently, on loyalty. We postulate the following hypotheses:

H3: Familiarity with bank personnel will be negatively associated with the use of Electronic Banking.

H4: Familiarity with bank personnel will be positively associated with bank personnel trust.

Conclusions

We have considered a definition of customer loyalty that recognizes the relationship between relative attitude and patronage behavior (Dick and Basu, 1994). When both are high, true loyalty exists. Our model suggests that high relative attitude may wane with the use of Electronic Banking. Although Electronic Banking may increase customer satisfaction due to such factors as increased convenience, satisfaction alone does not induce loyalty, particularly in retail banking. Instead, because Electronic Banking limits the frequency of face-to-face interaction and because Electronic Banking is easily imitated, we suggest that it will be more difficult for customers to differentiate between their primary financial service provider and its competitors.

Furthermore, because Electronic Banking may reduce many of the situational constraints, which traditionally acted as exit barriers, it may facilitate customers' ability to switch service providers. Furthermore, this paper suggests that establishing a trusted relationship between the customer and the bank contributes to increasing customers' switching costs because re-establishing trust and commitment with a new service provider takes time and repeated personal attention in order to mature. However, given that the breadth of traditional financial services is increasingly being automated and that several banks are adopting Electronic Banking as a direct alternative to the traditional customer service process, social bonds between the customers and bank representatives may become increasingly difficult to both maintain and establish. As technology rids the customer of situational constraints, patronage behavior will be more consistent with weakening relative attitudes and, thus, Electronic Banking may lead to lower customer loyalty.

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Figure 1. Impact of Electronic Banking on Customer Loyalty