Impact of Perceived Switching Costs on Customer Loyalty in Banks: An Empirical Investigation

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Abstract

The financial sector reforms 1992 coupled with knowledge explosion, surging competition and customer search for better service quality has led the banks to work on the customer retention through perpetrating the switching barriers. Customer acquisition is more costlier than retaining existing ones (Anabila et al., 2012) and banks, mostly, are competing on core service offerings. Keeping in view the growing importance of switching costs as a strategic weapon to retain customers, present study aims to examine the impact of switching costs on customer loyalty in banks of North India by using Partial Least square Equation Modelling (PLS-SEM). The data collected from 738 bank customers brought to the light that the financial, relational and procedural switching costs have positive and significant effect on customer loyalty. The results further revealed that relational switching cost has greater impact followed by procedural and financial switching costs on customer loyalty. The results call more attention to strengthen the financial switching costs to tighten the noose on customer churn rate.

Key Words: Perceived Switching Costs, Switching Barriers, Customer Churn, Customer Loyalty, Banks.

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Introduction

The implementation of financial sector reforms in 1992 has opened the doors for foreign banks in the Indian market which gave birth to increased competition among banks (Prasad and Ghosh, 2007). To gain the larger chunk of market share, banks began to adopt different relationship marketing strategies to create loyal customer base. Acquiring new customers is five times costlier than retaining new ones and retention of 15 percent of existing customers can improve the profitability of the company by 25 percent to 85 percent (Anabila et al., 2012). Tegambwage and Kasoga, (2022) reports that the loyal customers spread positive-word-of-mouth, indulge in repeat purchase, builds organization's brand image, increases profitability, and ensures continual survival of business. Furthermore, keeping in view the homogeneous nature of bank services, exposing the customers to different perceived switching costs are essential for at least two reasons to enhance the customer retention rate (Caruana, 2003). Firstly, even satisfied customers are lured by the competitors to their organizations (Kaur et al., 2012) and secondly, in competing markets, banks do not meet the customer expectations all-time (Zhao et al., 2022). Therefore, inflicting perceived switching costs on customers help the service provider to retain the defecting customers as they have to incur extra charges and sacrifice the existing benefits while changing the service provider. These switching costs further serves second chance to the service provider to motivate and satisfy the defecting customers.

The present study is anchored by Action Control Theory (ACT) which suggests that the switching costs control the customer actions regarding joining the alternative service provider owing to the high costs associated with it (Caruana, 2003). In other words, when customers intend to defect owing to unsatisfactory service encounters, they evaluate switching costs against benefits in pre-action phase which influence the customer decision regarding joining the alternative service provider owing to excess costs over benefits.

Keaveney, (1995) focuses on eight types of switching costs, namely, pricing, core service failure, inconvenience, service encounter failure, attractiveness of alternatives, ethical problems, employee response to service failure and involuntary switching while as Klemperer, (1987) has classified switching costs as relational, informational and contractual switching costs. Scant research is available on switching costs and its impact on customer loyalty, particularly, in Indian banks. Hence, present study aims to investigating the impact of perceived switching costs on customer loyalty in the Indian banks by using Action Control Theory (ACT).

Literature Review

Perceived Switching Costs (PSC)

Customer switching from one service provider to another service provider in search of better services is an indelible component of consumer behavior, particularly, when the market is nearly leaned towards perfect competition (Jones et al., 2000). This part of consumer behavior has attracted significant attention from scholars and practitioners to look-on the ways how customers could be retained through inflicting switching barriers (Yang and Peterson, 2004). Switching costs are defined as those costs which

are associated with the termination of existing relationship and joining to the another alternative organization (Jones et al., 2002). Aydin and Özer, (2005) reports that switching costs are the blend of physical, economic (costs incurred in the process of closing one bank account and opening in another bank) and psychological costs. Ganaie and Bhat, (2021) reports that perceived switching costs are the perceptions of the customers regarding the additional costs to be incurred in terminating the current relationship and setting-up new relationship. They further report that these perceived switching costs discourage the customers in pre-action phase to avoid termination of relationship, therefore, plays an essential role as customer retention strategy. Pick and Eisend, (2014) further reports that when tactics to generate perceived switching costs are in place, customers feel ongoing relationship more beneficial over another. From customer's point of view, Yang and Peterson, (2004) and Burnham et al., (2003) states that switching costs include evaluation cost (searching and evaluating the alternatives), learning cost (learning to use the product or service of the alternative organization), financial switching costs (incurring expenses to exit and establish new relationship, loss of loyalty points and termination or cancellation fee or penalties), relational switching costs (losing the benefits acquiring from friendships and familiarity) and procedural switching costs (incurring efforts and time in switching process). These switching costs have the potential to increase the costs over benefits for customers having switching intention (Yang and Peterson, 2004). Without having switching costs in place, customer defection causes loss of investment on acquiring such customers, puts negative impression on long-term customers and bars access to valuable customer data which, subsequently, calls adverse impact on the overall business performance (Amin et al., 2017).

Customer Loyalty (CL)

Customer loyalty (CL) is a function of customers willingness to patronize the products and services or continue the on-going relationship with the service provider (Fornell, 1992). Jenneboer et al., (2022) reports that CL is a degree to which customers are attitudinally and behaviorally ready to indulge in repeat purchase, continuously patronage the products or services and are less price sensitive. Oliver, (1997) defines loyalty as "a deeply held commitment to rebuy or patronize a preferred product or service consistently in the future, despite situational influences and marketing efforts having the potential to cause switching behavior". Hence, customer loyalty includes preferences, likings, positive behavior and future purchase intentions (Oliver, 1999). Attitudinal dimension of loyalty includes cognitive, affective and conative aspects which determines the behavioral loyalty. Chai et al., (2015) further reports that the behavioral aspect of loyalty can be further divided into two social and economic aspects. Social aspect includes customer's willingness to recommend and economic aspect includes the future purchase and switching intentions. Present study focuses on both aspects (attitudinal and behavioral) of customer loyalty as both are the essential components to measure the customer loyalty construct. Extant literature (Yang and Peterson, 2004; Kandampully et al., 2015 and Shammout, 2020) has affirmed that companies have substantial interest in creating loyal customer base owing to its potential of increasing sales, less advertising costs, positive-word-of-mouth, wider customer base, better service quality, higher customer value, positive brand image and less customer defection rate.

Perceived Switching Costs and Customer Loyalty

According to Burnham et al., (2003) discounts, loyalty point program, non-monetary benefits like calendars, pens etc., better interest rates and cross-selling services extended by the service provider exhort the customers to recommend the service provider to their siblings and friends. Customers enjoy and treat these benefits as savings which drives customer satisfaction and, eventually, customer loyalty (Lam et al., 2004). However, financial switching costs may also have negative impact on customer loyalty if customer perceives that the service provider is charging high service fee and the services offered are not satisfactory. In such circumstance's customers prefer to join another service provider regardless of high switching costs (Lee et al., 2001). Mittal, (1998) and Kaur et al., (2012) are of the opinion that even in the satisfied conditions, customers become prey of competitor's customer acquisition schemes. Blut et al., (2016) and Willys, (2018) have affirmed that financial switching costs (benefit and monetary loss cost) have positive impact on customer loyalty. Present study also believes that financial switching cost have direct influence on customer loyalty which is in line with Action Control Theory. Hence it is hypothesized that: -

H1: Financial switching cost positively impacts customer loyalty

Similarly, relational switching costs entails the customer relationships with the staff members and with the associated brand (Burnham et al., 2003). The helpful and polite attitude of frontline staff and the customer attachment towards brand encourages the customers to patronize and recommend the service provider to friends and family (Blut et al., 2016). These relations are developed over a long period of time and builds affective commitment (Evanschitzky et al., 2006). When customer intends to terminate the relationship with the existing service provider these costs inflict pain (Burnham et al., 2003). Furthermore, in line with the action control theory, these relational costs wary the defecting customer in pre-action phase and helps the service provider to retain the customers. Blut et al., (2016) affirmed that relational switching costs have positive impact on customer loyalty. However, Willys, (2018) has reported the contrary results with this effect. In context of banks, present study believes, developing customer relations by the use of familiarity, friendship, interaction motivates the customer to keep the on-going relationship. Hence, it is hypothesized that: -

H2: Relational switching cost positively impacts customer loyalty

On customer switching intention, procedural switching cost demands customer's physical and mental effort to shift from one to other service provider. Burnham et al., (2003) states that the economic risk, synthesis of information about the alternative service provider, setting up new relations and learning new working environment dissuades the defecting customer to join the alternatives. This relationship can be further viewed through cognitive dissonance concept which states that the customers feels discomfort on switching intention which forces them to continue the current relationship (Yap and Gaur, 2014). Moreover, Action

Control Theory also suggests that these procedural discomforts encourage the customer to change the switching decision in pre-action phase (Caruana, 2003). Blut et al., (2015) and Willys, (2018) has affirmed that procedural switching costs have positive impact on customer loyalty. In line with the action control theory and cognitive dissonance concept, present study believes that procedural switching costs are also helpful in keeping the customers loyal. Hence it is hypothesized that: -

H3: Procedural switching costs positively impacts customer loyalty

Sample Design

Given the limited resources and paucity of time, the study was restricted to selected union territories, i.e., Jammu and Kashmir and Delhi and the state of Punjab and within which major cities, namely, Srinagar, Jammu, New Delhi and Ludhiana were selected on the basis of population density as per census records 2011. Moreover, the empirical investigation is further restricted to four banks namely, Jammu and Kashmir Bank (JKB), Housing Development Finance Corporation (HDFC), Punjab National Bank (PNB) and State Bank of India (SBI). JKB was selected owing to its major financial activity and market size in UT of JK (*JK Bank Annual Report*, 2022). The HDFC bank was chosen because it being of India's largest private sector bank by market capitalization (Kothari, 2022). PNB was chosen as it is the second largest public sector bank in India and has the major portion of its branches and ATMs in Punjab (Punjab National Bank, 2020). Furthermore, SBI bank was selected as it is the largest public sector bank in India (Das and Singh, 2023). For determining the sample size, present study has chosen the following formula as prescribed by Godden, (2004).

$$sample\ size = z^2 \times (p) \times (1-p)/\ c^2$$

Whereas, Z refers to Z-value = 1.96; p refers to %ge of population picking a choice = 0.5; and c signifies confidence interval expressed in decimals = 0.04. Which equals to $1.96^2 \times (0.5) \times (1-0.5)/.0016$ = 600 sample size. However, to achieve our objectives, data was collected from 738 bank service users who had completed minimum 2 years in relationship with their associated banks. The exercise of data collection was completed by using one stage cluster sampling owing to heterogeneity of bank customers within and homogeneity in between the selected clusters (Jammu and Kashmir, Punjab and Delhi). On alternate days, visits were made to the different bank branches and the request was made to the bank customers to fill-up the questionnaire. Seventy-five percent (75%) respondents agreed to fill-up the questionnaire offline and twenty-five percent (25%) respondents preferred to respond through Google-link. Majority of the participants belonged to Jammu and Kashmir (34.96%) followed by Punjab (34.28%) and Delhi (30.76%). Similarly, bank wise, majority of the respondents have their bank accounts in PNB (27.91%) followed by SBI (26.56%), JKB (23.58%) and HDFC (21.95%) respectively. Moreover, information regarding age, gender, education level, income, and number of years in relationship with associated bank branches was taken into consideration in order to have representative sample. Out of total participants, 55.01% were males and 44.99% were females. Majority of the respondents belonged to the age group of 31-40 (29.13%), followed by 41-50 (28.60 %), 20-30 (25.20%) and above 51 (17.07 %) respectively. Furthermore, heavy participants were post graduates (47.01%) followed by participants having professional degree (30.90%) and bachelor's degree (22.09%) respectively. Majority of the respondents (41.06%) falls in the monthly income bracket of Rs 25000-50000 followed by Rs 50000-75000 (32.24%), above Rs 75000 (17.22%) and up to Rs 25000 (9.48%) respectively. Majority of the respondents (40.51%) have 10-13 years of bank relationship followed by above 14 years (21.82%), 06-09 years (21.14%), and 02-05 years (16.53%) respectively.

Research Instrument

To measure the perceived switching costs, twelve (12) items were adapted from the research study of Burnham et al., (2003) and to measure customer loyalty construct, nine (9) items were adapted from the research study of El-Manstrly and Harrison, (2013). Five-point Likert scale was adapted to measure the customer perceptions regarding perceived switching costs and loyalty ranging from 1 (disagree) to 5 (strongly agree).

Pretesting was performed on the adapted scales to confirm suitability of wordings and understandability of the questionnaire. First, the questionnaire was sent to the three marketing professors and senior marketing scholars to ensure the relevance of scale items and subsequently, questionnaire was distributed to 60 respondents to ensure that actual respondents understand and mark the scale items in one-go (debriefing technique). The feedback received from senior marketing scholars, professors and respondents was incorporated before fielding the questionnaire for final data collection.

Measurement Model

Keeping in view the reflective nature of measurement model, recommendations of Hair et al.,(2019) have been used to establish the reliability and validity of the model. The sequence of examining the measurement model is to first assess the indicator loadings followed by reliability, convergent validity and discriminant validity respectively. The indicator loadings of the scale items should be greater than 0.7., reliability (composite or Alpha coefficient) greater than 0.6, Average Variance Extracted (AVE) greater than 0.5. and HTMT ratio values less than 0.85. These parameters of examining measurement model were accessed by using Smart PLS software 3.9. The 500 iterated PLS Algorithm revealed that the factor loadings of all the scale items were greater than 0.7 except PrSc1 ("I think it will be difficult to learn the features of services offered and usage by another bank") and CL8 ("I will continue to use my bank if there is an increase in its interest rates") which arrived 0.132 and 0.044 respectively. After excluding the PrSc1 and CL8 for further analysis, the factor loading of switching costs ranged between 0.872 for RSC1 and 0.775 for PrSC5 (See Table.1). The alpha coefficients of financial, relational, procedural switching costs and customer loyalty, arrived at 0.789, 0.822, 0.839 and 0.922, respectively which meets the minimum threshold of 0.6. Moreover, the composite reliability of financial, relational, procedural switching costs and customer loyalty arrived at 0.876, 0.894, 0.886 and 0.936 respectively which also meets the minimum threshold of 0.6. Furthermore, the average variance extracted of financial, relational, procedural switching costs and

customer loyalty arrived at 0.703, 0.737, 0.608 and 0.646 respectively which are above the yardstick of 0.5. Hence establishes the convergent validity (See Table.1 and Fig.1). The discriminant validity of the understudy constructs was examined through the Fornell-Larcker criterion and HTMT ratio. The square root of average variance extracted for each variable was found greater than the inter-correlations of other constructs and HTMT ratio values were also found below 0.85 which ranged between 0.592 and 0.712 (See Table 2). Hence, establishes the discriminant validity.

Table: 1Factor Loadings, Reliability and Average Variance Extracted (AVE)

Constructs	Item Codes	F. R	A.C	C.R	AVE
Financial Switching Cost	If I switch to other bank, I will leave a benefit of being a long-term customer of existing bank (FSC1)	0.850	0.789	0.876	0.703
	If I switch to another bank, I will lose certain amount kept as minimum deposit balance (FSC2).	0.829			
	It needs much money to open new account in another bank from formalities to minimum deposit (FSC3).	0.835			
Relational Switching Cost	I support my current bank as a great bank which has a good public image (RSC1).	0.872	0.822	0.894	0.737
	I think I am more comfortable to interact with the people working at my current bank (RSC2).	0.855			
	If I switch to other bank, I will miss the employees to whom I was interacting with (RSC3)	0.849			
Procedural Switching Cost	I think switching to new bank will add unexpected disturbance to me (PrSc2).	0.778	0.839	0.886	0.608
	If I switch to other bank I might end up with bad service for a while (PrSc3).	0.775			
	It is much difficult to compare the benefits of my bank with other banks (PrSc4).	0.779			
	It takes time to go through the steps of switching to a new service provider (PrSc5).	0.775			
	There are lot of formalities involved in switching to a new bank (from closing existing to opening new account) (PrSc6).	0.792			
Customer Loyalty	I am happy with the services that my bank provides to me (CL1).	0.809	0.922	0.936	0.646
	I say positive things about my bank to other people (CL2).	0.800			
	I spend more money at my bank than other banks (CL3).	0.814			
	My bank has more schemes than other banks (CL4)	0.781			
	I consider my bank first choice when I need any type of financial service (CL5).	0.802			
	I encourage friends and relatives to use the bank to which I am associated (CL6).	0.788			
	I have bought more services from my bank than other banks (CL7).	0.819			
	I save and borrow more money in my bank than other banks (CL9).	0.817			

Notes: F.R = Factor Loadings; A.C = Alpha Coefficient; C.R = Composite Reliability; AVE = Average Variance Extracted.

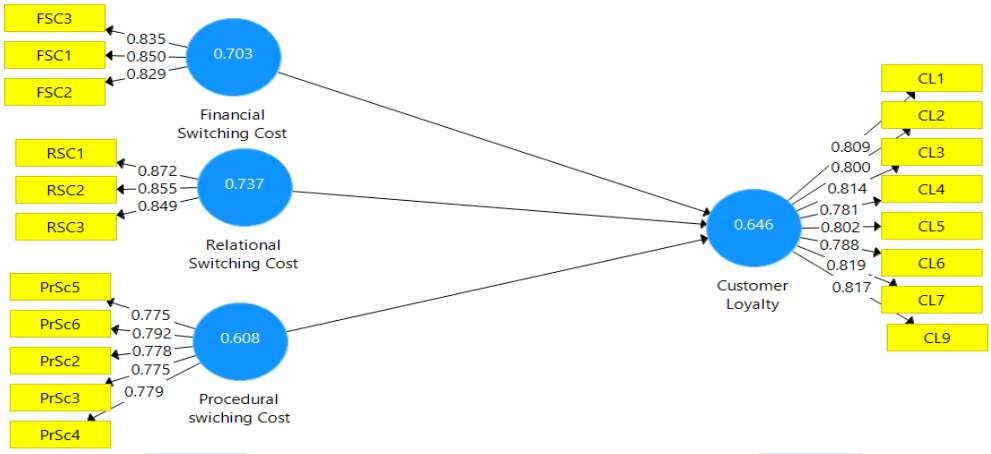

Fig.1 Factor loadings and AVE of the outer model.

Table: 2Discriminant Validity

Fornell-Larcker Criteria				
Constructs	**CL**	**FSC**	**PrSC**	**RSC**
CL	**0.804**			
FSC	0.506	**0.838**		
PrSC.	0.579	0.562	**0.780**	
RSC	0.62	0.542	0.581	**0.859**
Heterotrait-Monotrait HTMT Ratio				
CL				
FSC	0.592			
PrSC	0.658	0.690		
RSC	0.712	0.672	0.700	

Notes: CL: customer loyalty; FSC: Financial switching cost; RSC: Relational Switching cost; PrSC: Procedural switching cost.

Structural Model

Subsequent to the validation of outer model, structural model is first examined to check the robustness of the model through collinearity assessment, R-square, f-square followed by Q-square respectively (Hair et al., 2019). To ensure that the multicollinearity does not bias the results, the threshold for VIF should be less than 3 or 5. R-square of the model should be greater than 0.25. Higher the values of R-square means better explanatory power of the model (Hair et al., 2019). Q-square of the endogenous variable/s should be greater than zero to ensure that the model has sufficient predictive power.

The Variance Inflation Factor (VIF) for financial, relational and procedural switching costs arrived at 1.628, 1.735 and 1.682 respectively which testifies that the multicollinearity is not an issue for the present study. Furthermore, the 5000 complete bootstrapping procedure revealed that the acceptable R-square of the model is 0.469 which means 46.9% change is customer loyalty is accounted for financial, relational and procedural switching costs (see fig.2). Similarly, the f-square for financial (0.024), procedural (0.083) and relational switching costs (0.16) on customer loyalty shows that the removal of financial and procedural switching costs have weak effect on R-square value of customer loyalty and relational switching cost has moderate effect on the R-square value of customer loyalty as the f-square values greater than 0.02, 0.15 and 0.35 signifies small, medium and strong effect respectively (Hair et al., 2019). Furthermore, the blindfolding procedure (omission distance = 5) revealed that the predictive relevance of the model is 0.299 which shows that the model has satisfactory predictive relevance as it is greater than zero (see fig.3).

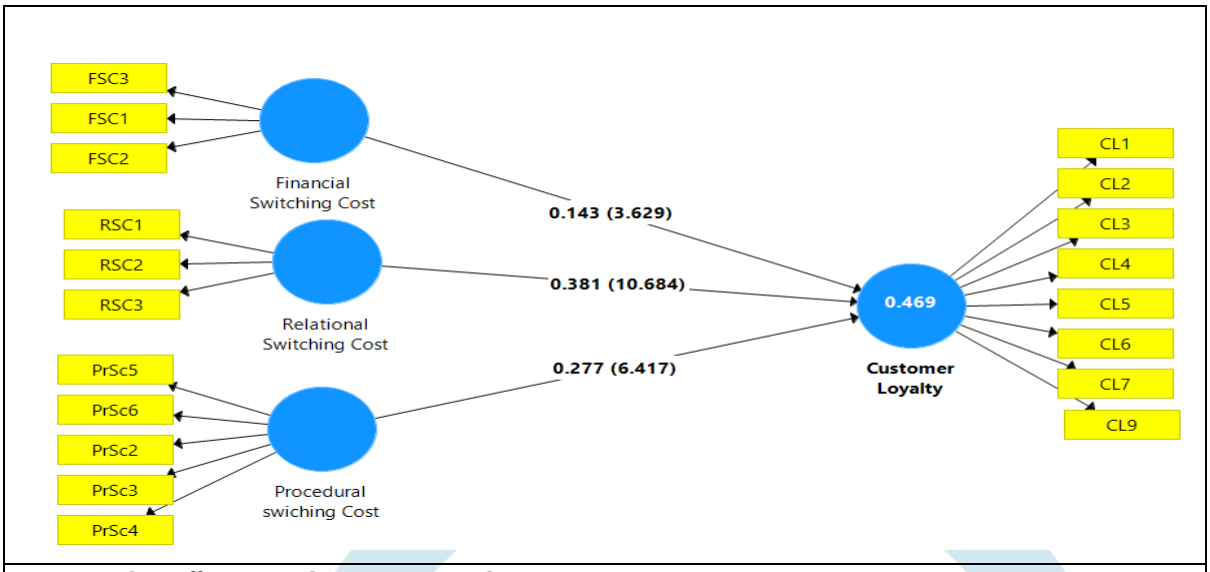

Fig.2: Path coefficients with T-statistics and R-square

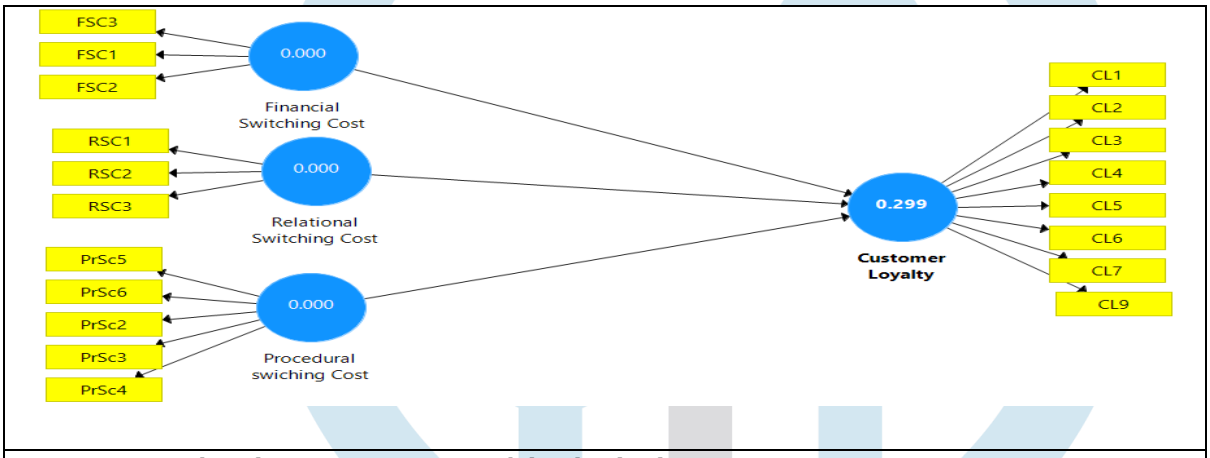

Fig.3: Q-square based on Construct Cross validated redundancy

Hypotheses Testing

In line with the objective of the study, i.e., impact of perceived switching costs on customer loyalty in banks followed by the research hypothesis H1 (Financial switching cost positively impacts customer loyalty) study results revealed (through 5000 complete bootstrapping) that financial switching cost has significant and positive impact on customer loyalty (β = 0.143, t-value = 3.629, p-value <.01). The results showed that the customer's decision to switch the current relationship is significantly influenced by the benefit and monetary loss costs. **Hence, H1 is accepted**. Similarly, the results with respect to the second hypothesis (Relational switching cost positively impacts customer loyalty) revealed the significant and positive impact of relational switching costs on customer loyalty (β = 0.381, t-value = 10.684, p-value <.01). The significant results of this hypothesis mean that the customer switching intention is influenced by the personal and brand relationship loss costs. **Hence, H2 is accepted**. Lastly, with respect to hypothesis H3 (Procedural switching cost positively impacts customer loyalty) results showed the positive and significant impact of procedural switching costs on customer loyalty (β = 0.277, t-value = 6.417, p-value <.01). These results mean that the customer switching intention is significantly influenced by the evaluation, learning and setup costs. **Hence, H3 is accepted.** The summary of hypotheses testing is given in Table. 3. The results further brought to the light that the financial switching costs (β = 0.143) have the least effect followed by the procedural (β = 0.277) and relational switching costs (β = 0.381) on customer loyalty.

Table. 3. Summary of Hypotheses Testing

Hypotheses	Relationship	Beta	T-value	S.E	P-value	Decision
H1	FSC-> CL	0.143	3.629	0.040	0.000	Supported
H2	RSC-> CL	0.381	10.684	0.043	0.000	Supported
H3	PrSc-> CL	0.277	6.417	0.023	0.000	Supported

Discussion

The present investigation was a humble attempt to answer the three questions. First, "does the financial switching cost significantly impacts customer loyalty?". Second, "does the relational switching cost have significant positive impact on customer loyalty?" and third, "does procedural switching costs significantly impacts customer loyalty?". With respect to the hypothesis H1 the results showed financial switching cost have positive and significant influence on customer loyalty which is consistent with the research studies of Burnham et al., (2003), Aydin & Gokhan, (2005) and Willys, (2018). The significance of this hypothesis is also in line with the action control theory which suggests customers control the switching action due to the pain of monetary and benefit loss costs. In other words, it means that the customer perceives the existing relationship more beneficial than switching to new one as they perceive the costs would outweigh the benefits. Furthermore, comparatively, the financial switching costs are less effective than the procedural and relational switching costs. The possible reasons might me that the customers get slightly inclined to the notion that the these monetary and benefit loss costs can be regained or replaced when joining the alternative service provider. In support of this argument, Hofman-Kohlmeyer, (2016) states that the monetary benefits extended to the customer doesn't guarantee customer retention. Furthermore, the results also revealed that the relational switching costs have positive and significant impact on customer loyalty (H2). The acceptance of this hypothesis is in line with the empirical investigations of Caruana, (2003), Blut et al.,(2016) and Kim et al., (2018). The weight of relational switching costs is comparatively highest ($\beta = 0.381$) on the customer loyalty. This also means that in banks relational relationships with the staff are most valued by the customers. similarly, the bootstrapping procedure also revealed that the procedural switching costs have significant positive impact on customer loyalty (H3). The acceptance of this hypothesis is in line with the research studies of Blut et al., (2016), Willys, (2018) and Kim et al., (2018). The significance of this hypothesis refers that procedural switching costs (evaluation cost, learning cost and setup costs) are painful for customer switching and forces the customers to maintain the existing relationship. However, comparative to relational switching costs, procedural switching costs have least effect on customer loyalty. The reasons behind this phenomenon would be that the procedural switching costs are the negative in nature and do not add value to the customer-bank relationship (Jones et al., 2007). The acceptance of this hypothesis is also in line with the action control theory and cognitive dissonance theory which suggests that the infliction of high exit procedural switching costs forces the customer to remain with the existing relationship and inculcate the perception that the existing relationship is beneficial than shifting to the alternative one.

Limitations and Future research Agenda

The present study was limited to the selected banks (Jammu and Kashmir Bank, Housing Development Finance Corporation, Punjab National Bank and State Bank of India) based on the maximum foot-fall in terms of ATM installations and bank branches in selected cities of North India (Srinagar, Jammu, New Delhi and Ludhiana). Future researchers are recommended to conduct such investigation by including more banks and cities to generalize the results. Present study investigated the role of financial, relational and procedural switching costs on customer loyalty. Future researchers are recommended to study the mediating role of customer engagement, e-relationship marketing, e-service quality for strengthening the relationships of understudy variables. Moreover, employing mixed research tools are recommended to get rid of the biasness arisen out of some unfair opinions due to less bank related knowledge of respondents.

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