

# **CUSTOMER LOYALTY IN FINANCIAL SERVICES FROM A SERVICE-DOMINANT LOGIC PERSPECTIVE**

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Several researchers argue that value co-creation is considered an important strategy for businesses competing to satisfy personalised demands and to gain competitive advantage in today's fast paced and difficult marketplace (Vargo and Lusch, 2004a; Prahalad and Ramaswamy, 2004b; Mascarenhad et al., 2004; Zhang and Chen, 2006). Mascarenhad et al. (2006) contend that distinct marketing offerings resulting from high quality interaction between customers and company will elicit positive customer experiences that generate sustainable customer loyalty. However, despite the increasing amount of research on service-dominant logic and value co-creation (e.g. Gronroos, 2008; Payne et al., 2008; Prahalad and Ramaswamy, 2004; Vargo and Lusch, 2004, 2006, 2008), little empirical research has attempted to bind together the notions of co-creation, customer experience and customer loyalty. This research explores how involving customers in co-creating value with a firm influences customer loyalty in the competitive financial services market.

The industry chosen to study these issues is the unit trust industry in Malaysia. Two reasons make this an appropriate choice. First, the unit trust industry is developing rapidly. Similar to the other financial services in the country, the dual forces of technology and regulation are generating competitive intensity amongst unit trust companies. Therefore, there is a need for the market players to innovate and find new ways of doing things in order to compete successfully. Secondly, unit trust funds as an investment category require a high degree of interaction between the representatives of unit trust companies and customers. Therefore, it provides a prime opportunity for exploring the nature and impact of value co-creation practices on customer loyalty.

## **LITERATURE REVIEW**

### **Service-Dominant Logic**

Vargo and Lusch (2004) contend that the idea that a service could increase competitive advantage was developed upon a goods-dominant conceptual foundation. Services have variously been described as residual activities that aid in the production of goods (Fisk et al., 1993), value-added activities (Dixon, 1990), or at best, a particular intangible characteristic of a tangible product (Christopher, 1991). In their seminal article published in the *Journal of Marketing*, Vargo and Lusch (2004a) called for a shift towards a new paradigm in the marketing discipline, i.e. service-dominant logic. They suggest that the economic world is all about service. That is, all economic entities are service providers to one another. They consider service a process of doing something (application of knowledge and competencies) for the benefit of another party – in its own right, without reference to goods and identify service, rather than goods, as the primary focus of exchange activity (Vargo and Lusch, 2004a).

The most critical distinctions between goods-dominant logic and service-dominant logic are found in the conceptualisation of service, and value and value co-creation. A service-centred perspective disposes of the limitations of thinking of marketing in terms of goods taken to market, and points to opportunities for expanding the market by assisting the consumer in the process of value creation. The unique matching of firm capabilities with customer needs, guided by an on-going conversation between them, is proposed to generate long term customer loyalty and competitive advantage (Vargo et al., 2007). Prahalad and Ramaswamy (2004 a,b,c) build upon Vargo and Lusch's (2004 a,b) notion of co-creation by suggesting a move from the firm focussing upon creating products in anticipation of consumer preference to involving the customer in the creation of value. Prahalad and Ramaswamy (2004 a,b,c) point out that the notion of co-creation has largely come about as a consequence of the changing roles of the consumer and the marketer. The authors comment that with the emergence of connected, informed, networked, empowered, and active consumers, who are armed with new tools and dissatisfied with available choices, are now seeking to exercise their influence in every part of the business system. They want to interact and co-create value, not just with one firm but with whole communities of professionals, service providers, and other consumers. Several authors claim that, involving customers to co-create value is considered an important strategy for businesses to gain competitive advantage in today's fast paced and difficult marketplace. This is because interactivity and doing things with the customer versus doing things to the customer enable firms to place a high priority on understanding and satisfying customer's personalised demands (Vargo and Lusch, 2004; Prahalad and Ramaswamy, 2004; Mascarenhas et al., 2004; Zhang and Chen, 2006).

### **Customer Experience and Loyalty**

Research on customer loyalty has generated two perspectives in defining and operationalising customer loyalty, namely behavioural and attitudinal loyalty. (Dick and Basu, 1994; Oliver, 1999; Edvardsson et al., 2000; Reichheld et al., 2000; Chaudhuri and Holbrook, 2001; Gustafsson & Johnson, 2002). However, several researchers argue that there must be a strong 'attitudinal commitment' to a brand for true loyalty to exist (Day, 1969; Dick and Basu, 1994; Reichheld, 1996). Dick and Basu (1994) state that, "customer loyalty is viewed as the strength of the relationship between an individual's relative attitude and their repeat patronage" (p. 99). They suggest that both a favourable attitude and repeat purchase are required to define loyalty.

Customer experience originates from a set of interactions, direct and indirect, between a customer and a product or a company, throughout the consumption chain which provoke a reaction (internal and subjective) (Johnston and Clark, 2005; Mascarenhas et al., 2006; Meyer and Schwager, 2007; Gentile et al., 2007). Direct contact generally occurs in the course of purchase, use, and service, and is usually initiated by the customer, and indirect contact concerning customers' unplanned encounters with messages sent by a company's products, services, or brands, and take the form of word-of-mouth recommendations or criticisms, advertising, news reports, reviews, and so forth. The outcome of a customer experience could be tangible outputs, value, emotions and judgement and/or intentions (Johnston and Clark, 2005). In service-dominant logic, customer experience is linked to the concept of value in use for the customer (Vargo and Lusch, 2004a). Berry et al. (2006, 2007) proposes that clues that make up a total customer experience fit into two categories. The first is the 'functional' clues concerning the technical quality of the offering. These clues are the "what" of the experience, reflecting the reliability and functionality of the good or service. The second 'emotional' category includes two types of clues: "mechanics" (clues emitted by things) and "humanics"

(clues emitted by people). Functional clues primarily influence customers' cognitive or calculative perceptions of service quality. Emotional clues reveal much about an organisation's commitment to understanding and satisfying customers' need and wants, they primarily influence customers' emotional or affective perception. All clue categories are equally important to the customer experience and they work synergistically to influence customer's attitude (thought, feelings) that drive behaviour (Berry et al., 2002, 2007). Mascarenhas et al. (2006) proposes that a high total customer experience will automatically generate high and lasting customer loyalty.

Consistently, service-dominant logic states that customer experience is the individual's judgement of the sum total of all the functional and emotional experience outcomes during user consumption (Vargo and Lusch, 2004). Therefore, it is important for the service provider to manage both functional and emotional experience outcomes, and co-create with their customers in order that the value proposition is experienced in a way which brings highly perceived value to the customer.

### Research Objective

The above review of relevant literature suggests that there should be an association between value co-creation, customer experience, and customer loyalty. Therefore the central question addressed in this study is '*how involving customers in co-creating value with a firm influences customer loyalty in the financial services context?*' The following hypotheses were developed to explore this question:

- H1: Value co-creation relates positively to customer experience.*
- H2: Customer experience will positively influence attitudinal loyalty.*
- H3: Customer experience will positively influence behavioural loyalty.*
- H4: Attitudinal loyalty relates positively to behavioural loyalty*
- H5: Customer experience mediates the relationship between value co-creation and attitudinal loyalty.*
- H6: Customer experience mediates the relationship between value co-creation and behavioural loyalty.*
- H7: Attitudinal loyalty mediates the relationship between customer experience and behavioural loyalty.*

### METHODOLOGY

This research was based on the administration of a structured self-administered questionnaire. Given the breadth of concepts explored in this study measures were adopted from various apriori studies. Table 1 summarises the source of these measures:

Table 1: Source of Measurement items

| Concept                      | Source of Measure  |
|------------------------------|--|
| Value co-creation measures   | Anderson and Weitz (1992); Granados et al., (2008); Prahalad and Ramaswamy (2004 a & b); Sharma and Patterson (1999). Bettencourt's (1997); Vargo and Lusch (2004) |
| Customer experience measures | Berry et al. (2002, 2007); Gronroos (1988); Sharma and Patterson (1999); Vargo and Lusch (2004);Zhang and Chen (2006)  |
| Customer loyalty measures    | Dick and Basu (2004); Oliver (1999); and Zeithaml et al. (1996)  |

Pre-testing of the questionnaire was conducted by arbitrarily selecting ten customers from the sample. The questionnaire was also sent to a licensed financial planner and some unit trust consultants to elicit their comments in order to assess questions for face validity (Sekaran, 2007). Based on their feedback, some adjustments were made to fit the unit trust context. A

purposive sample was constructed of Malaysian customers who were currently customers investing in unit trust funds managed by various unit trust management companies. The researcher's networks were used and as such this is a convenience sample. Out of 200 hard copies self-administered questionnaire distributed, 116 copies were returned equivalent to a 58% respond rate. After eliminating questionnaires with extensive missing data the final sample consisted of 100 observations. For the online survey, approximately 4,600 emails disseminated and 185 fully completed responses were received, equivalent to a 4% respond rate.

## RESEARCH RESULTS

The respondents in this study could generally be described as middle income Malaysian Chinese. Respondents consisted of 165 males (58%) and 120 female (42%) and were mostly Chinese (70%). The ethnic bias can be attributed to the primary researcher using a convenience sampling method. The age of the respondents ranged from 26-55 (247, 87%), with over half holding a university qualification. More than half of respondents (181, 63%) had been investing with a unit trust company for 1-5 years. The majority of the respondents considered themselves knowledgeable in terms of investment services and products (186, 65%), and experienced in investing (163, 58%).

Results of data analysis support all hypotheses. Value co-creation displayed a significant and positive relationship with customer experience ( $R = 0.84, p < .05$ ), thus supporting H1. Customer experience showed a significant and positive relationship with attitudinal loyalty ( $R = 0.83, p < .05$ ), supporting H2, as well as behavioural loyalty ( $R = 0.83, p < .05$ ) supporting H3. Attitudinal loyalty was found to exhibit a significant and positive impact on behavioural loyalty ( $R = 0.89, p < .05$ ), H4 is thus supported. Statistical testing for mediating variables, utilising the Baron and Kenney four steps method (Baron and Kenny, 1986), showed that customer experience has a strong mediation effect on both perspectives of customer loyalty, thus supporting H5 and H6 (refer table 2). Finally, attitudinal loyalty was found to have a strong mediation effect on behavioural loyalty, therefore H7 is also supported.

Table 2: Path Analysis for Testing Mediating Variables

| Initial variable    | Outcome             | Mediator            | Path Analysis      |                    |                                     |      |
|---------------------|---------------------|---------------------|--------------------|--------------------|-------------------------------------|------|
|                     |                     |                     | Step 1<br>X→Y<br>c | Step 2<br>X→M<br>A | Step 3 and 4<br>X and M → Y<br>b c' |      |
| (X)                 | (Y)                 | (M)                 |                    |                    |                                     |      |
| Value co-creation   | Attitudinal loyalty | Customer experience | 0.78               | 0.84               | 0.84                                | 0.30 |
| Value co-creation   | Behavioural loyalty | Customer experience | 0.79               | 0.84               | 0.84                                | 0.33 |
| Customer experience | Behavioural Loyalty | Attitudinal loyalty | 0.82               | 0.83               | 0.91                                | 0.27 |

## DISCUSSION AND CONCLUSION

The two value co-creation activities namely information symmetry and dialogue displayed significantly strong positive impact on customer experience. This means that the more customers interact with their financial adviser and the company to jointly create value, the more favourable is their experience with the service. These findings are consistent with the conceptual research in the field of service-dominant logic and value co-creation. It also implies that for services characterised as high in credence qualities and low in search qualities customers rely highly on extensive information to enable them to effectively interact with the service provider in the value creation process. The findings revealed that companies can enhance customer experience remarkably by ensuring that most relevant information are

available and accessible by their customers. The second most important value co-creation activity was dialogue. This means that the more conversations and interactions that take place between the customer, financial adviser and the service employees of the company, the higher customer's judgement of the experience outcome.

Next, the results provided strong empirical support for the conceptual work that proposed customer experience as a determinant of customer loyalty (Berry, 2002; Mascarenhas et al., 2006; Pine and Gilmore, 1998). The findings suggest that strong and positive customer experience perceived and evaluated during the service consumption is significant in influencing both attitudinal and behavioural perspectives of customer loyalty. The findings also propose that customer experience plays an important mediating role between value co-creation and customer loyalty. This is consistent with the theoretical concept of value co-creation that stresses personalised co-creation experiences as the source of unique value to foster customer loyalty (Prahalad and Ramaswamy, 2004c).

The findings reveal that due to the credence properties and long time periods required to see the real outcomes of investment services, technical outcome is not the top of mind in influencing customer's evaluation of service experience in this context. The various service encounters when the customer interacts with the company's service employees and the company's capability in providing exactly what customer want and customised service during value co-creation take on added significance in influencing their attitude and behaviour toward the company.

Lastly, the findings confirm the arguments that attitude and behaviour are consistent in most situations and that attitude is a strong predictor of behaviour (Ajzen and Fishbein, 1977; Arrondo et al., 2002). It upholds the notion that companies should concurrently focus on building attitudinal and behavioural loyalty to achieve true loyalty as proposed by several scholars (Oliver, 1999; Dick and Basu, 1994; Day, 1969; Rowley, 2005). The findings also indicate that attitudinal loyalty plays an important mediating role between customer experience and behavioural loyalty. Therefore, validates Berry's (2002, 2007) argument that it is the customer's experience that evokes the perception of value which influences customer's attitude that drive behaviour.

## **LIMITATIONS**

First, owing to lack of empirical research in the area of value co-creation, particularly in the financial services context, an appropriate scale for value co-creation activities could not be found in the extant literature. Therefore, scales used to measure the four building blocks of co-creation activities were developed based on the researcher's understanding of relevant literature to suit the financial services context. It may not represent the most important value propositions from the customer's perspective. Ideally, a focus group discussion or interview with customers would be more effective to develop a more precise measurement scale. Next, this research was limited to study customers from only one service context – the financial services, particularly the unit trust industry in Malaysia. Therefore, the findings cannot be generalised to other contexts.

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