

FINANCIAL FACTORS AFFECTING CUSTOMER RETENTION IN COMMERCIAL BANKS IN KENYA: A CASE OF COMMERCIAL BANKS IN THIKA TOWN, KENYA

¹ **Janet C. Siele**

MBA (Finance) Jomo Kenyatta University of Agriculture and Technology
janchep87@gmail.com

² **Dr. Willy Muturi**

*Chair of Department, Department of Economics Accounting and Finance,
Jomo Kenyatta University of Agriculture and Technology*
mmuturi2001@yahoo.com

Abstract

The main aim of this research was to assess the financial factors affecting the in commercial banks in Kenya. Customer retention is a fundamental tool that banks can use to gain a strategic competitive advantage and survive in today's banking industry environment. The banking industry has also been experiencing a high rate of labor turnover. This study examines the financial factors affecting customer retention in Commercial Banks in Kenya with a survey of Banks in Thika Town. The study also sought to determine the effects of financial products, online services, interest rates and bank charges on customer retention in Commercial Banks in Kenya. This research study used a descriptive research design. The study targeted the heads of finance departments, credit departments and branch managers in all the 22 commercial banks in Thika Town. The sample was 66 respondents from the three categories. Primary data was used and it was collected through self-administered questionnaires and it was later analysed with both descriptive and inferential statistics. The effect of all the variables was found to be statistically significant. Financial innovation and online services were found to reduce the tendency of the customers to leave the bank. Interest rate and bank charges were found to increase the tendency of the customers to leave the banks. The study concluded that all the factors were relevant in explaining customer retention. The study also recommended that the banks and the government should come up with measures that reduce interest and charges to the customers to help retain them in the banking industry. The banks were also advised to come up with more financial innovations and online services since these were found to have significant effect on customer retention.

Keywords: Bank Charges, Commercial Bank, e-banking, Financial Products

INTRODUCTION

1.1 Background of the Study

The current banking industry has become one of the highly competitive industries with banks not only competing among each other but also competing with non-banks and other financial institutions (Ismail and Panni, 2009). Most bank product developments are easy to duplicate and when banks provide nearly identical services, they can only distinguish themselves on the basis of price and quality. Therefore, customer satisfaction and retention is potentially an effective tool that banks can use to support their survival in the industry. One strategic focus that banks can implement to remain competitive would be to retain as many customers as possible (Doucouliagos and Stanley, 2013). The costs of acquiring customers to “replace” those who have been lost are high because the expense of acquiring customers is incurred only in the beginning stages of the commercial relationship (Gautam, 2012). In addition, longer-term customers buy more and, if satisfied, may generate positive word-of-mouth promotion for the company and they also take less of the company’s time and are less sensitive to price changes. In addition, customer retention is very important because it has a bearing on costs and profitability over time (Brennant and Ritch, 2010). Ismail and Panni (2009) also explained that customer retention involves steps taken by a selling organization in order to reduce customer defection and successful customer retention starts with the first contact an organization has with a customer and continues throughout the entire lifetime of a relationship. Also customer retention is important to most companies because the cost of acquiring a new customer is far greater than the cost of maintaining a relationship with a current customer (Mishra and Singh, 2014).

In Kenyan perspective, Njane (2013) indicates that the banking industry is highly competitive, with banks not only competing among each other; but also with non-banks and other financial institutions. Most bank product developments are easy to duplicate and when banks provide nearly identical services, they can only distinguish themselves on the basis of price and quality. Therefore, customer retention is potentially an effective tool that banks can use to gain a strategic advantage and survive in today’s ever-increasing banking competitive environment. The majorities of banks have non-domestic owners, and are not very diversified in terms of the products and services they offer (Owino, 2013). This suggests that most organizations have reached the maturity phase of the product lifecycle and has become commoditized, since banks offer nearly identical products. This carries the danger of creating a downward spiral of perpetual price discounting: fighting for customer share.

1.1.1 Commercial Banks in Kenya

Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and other various prudential guidelines issued by the Central Bank of Kenya (CBK). All of the policies and regulations that administer the entire banking industry centres in lifting the controls towards the management and equitable services (CBK, 2015). The Kenyan financial sector has undergone tremendous changes in the last two decade. Mwando (2013) for instance documents that financial products have increased, activities and organizational forms have also improved and the overall efficiency of the financial system has increased (CBK 2015). Commercial banks branch network has grown from 530 in 1999 to 1,102 branches by end of June 2011, ATMs increased from 262 to 2,021, number of deposit accounts from approximately 1million with 16,673 staff to 12.8million with 28,846 staff over the same period (CBK, 2015). Total assets increased from Ksh. 387,371 million in December 1999 to Ksh. 1.9 trillion in June 2011 while customer deposits from Ksh. 235 billion to Ksh. 1.4 trillion in June 2011 (CBK, 2015). The last two decades can be classified as the era of technological innovation and emerging financial instruments. The period witnessed emergence of new products such as Islamic banking, automatic teller machines (ATMs), plastic money and electronic-money (e-money) amongst others within the banking sector.

1.2 Statement of the Problem

According to Gautam (2012), the banking industry is highly competitive, with banks not only competing among each other; but also with non-banks and other financial institutions. Therefore, customer retention is potentially an effective tool that banks can use to gain a strategic advantage and survive in today's ever-increasing banking competitive environment. Brennan and Ritch (2010) cited that to acquire a new customer cost the organization five times the cost the company uses to satisfy and retain the current customer. They further notes that a 2% increase in customer retention has the same effect as decreasing costs by 10% and that depending on the state of any industry, if an organization reduces customer defection rate by 5%, this can on the other hand increase the organization's profitability by 25 to 125%. The banking industry has lost a significant market share to the vast growing microfinance and SACCOs. Despite the importance of consumer retention in the banking industry in Kenya, very few empirical studies have investigated financial factors affecting customer retention. This study therefore seeks to examine the financial factors affecting customer retention in Commercial Banks in Kenya with a survey of Banks in Thika Town.

1.3 Objectives of the Study

1.3.1 General objective

The main objective of this study is to examine the financial factors affecting customer retention in Commercial Banks in Kenya with a survey of Banks in Thika Town.

1.3.2 Specific objectives

The specific objectives of the study will be;

1. To determine the effects of financial products offered on customer retention in Commercial Banks in Kenya
2. To establish the effects of online services on customer retention in commercial banks in Kenya
3. To find out the effect of interest rates on customer retention in Commercial Banks in Kenya
4. To assess the effect of bank charges on customer retention in Commercial Banks in Kenya

1.4 Research Questions

The study will be guided by the following research questions;

1. What is the effect of financial products offered on customer retention in Commercial Banks in Kenya?
2. What is the effect of online services on customer retention in commercial banks in Kenya?
3. What is the effect of interest rates on customer retention in Commercial Banks in Kenya?
4. What is the effect of bank charges on customer retention in Commercial Banks in Kenya?

1.5 Significance of the Study

This study will be of importance to the various stakeholders who include government regulators, Commercial Banks, shareholders, Microfinance institutions, investors, academia and the general public.

To the management of commercial banks in Kenya, the study will provide information on how various financial factors like financial products, online services, interest rates and bank charges influence customer retention in Commercial Banks in Kenya. In the recent past, there has been a lot of competition between various commercial banks in Kenya and hence the importance of

customer retention. Commercial banks will therefore be better positioned and able to implement the recommendations of this study that will be necessary in enhancing their customer retention and in development of strategies to improve customer retention.

To the government of Kenya and policy makers, the study will provide information on the financial factors affecting customer retention in Commercial Banks in Kenya that can be used to formulate policies to regulate competition and protect various stakeholders in commercial banks in Kenya.

LITERATURE REVIEW

The study included four theories: Credit market clearing (neo-classical) theory, loan pricing theory, innovation diffusion theory and competition theory.

2.2.1 Credit Market clearing (neo-classical) theory

This theory suggests that if the collateral and other pertinent restrictions remain as given, then it is only the lending rate that determines the amount of credit that is dispensed by the banking sector. Therefore, with an increasing demand for credit and a fixed supply of the same, interest rates will have to rise (Pitelis, 2012).

2.2.2 Loan Pricing Theory

The theory suggests that banks cannot always set high interest rates to maximize income. Banks should consider the problems of adverse selection and moral hazards since it is very difficult to forecast the borrower type at the start of the banking relationship (Chmura, 1995). If interest rates are too high, adverse selection problems are imposed since high risk borrowers are willing to accept these high rates.

2.2.3 Innovation diffusion theory

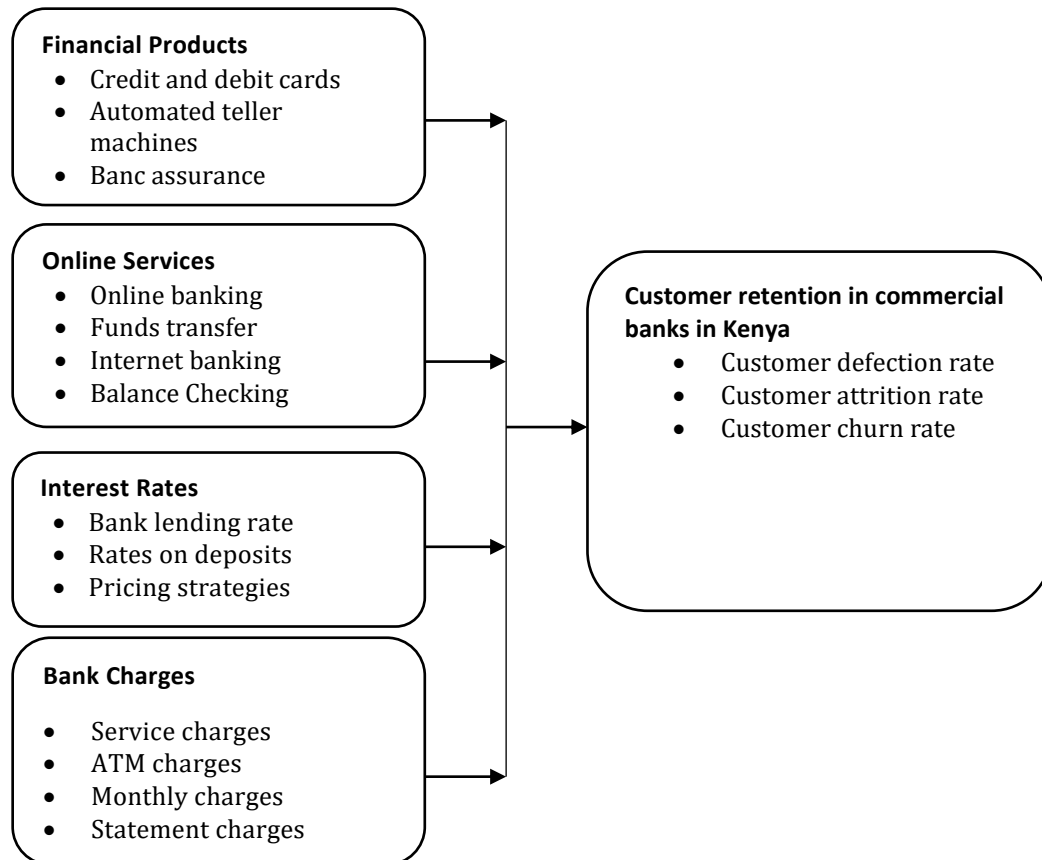
Innovation Diffusion Theory (IDT), was formulated by Everett M. Rogers in 1962, and it laid down the fundamental foundation for the future of revolution dissemination research (Rogers, 1962). The theory integrates communication, sociology and economics in adoption-dissemination across the disciplines.

2.2.4 Competition Theory

Competition occurs when two or more organisations act independently to supply their products to the same group of consumers (Hunt and Morgan, 1997). The competition theory explains how firms try to win customers patronage and loyalty through service excellence, meeting customers' needs and providing innovative products.

2.3 Conceptual Framework

This study seeks to investigate on the financial factors affecting customer retention in Commercial banks in Kenya. The independent variables in this study will be financial products, online services, interest rates and bank charges. On the other hand the dependent variable will be customer retention in commercial banks.



Independent Variables

Dependent Variable

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

The target population comprised of respondents who were heads of finance departments, credit departments and branch managers in all the 22 commercial banks in Thika town, Kenya. This research study used stratified sampling technique to select the most replica sample among the various commercial banks in Thika town, Kenya. Since the population of study is small it was also used as the sample size for the study. Each bank contributed three respondents to the sample that is, one for each strata. Primary data was collected by use of self-administered

questionnaires. The data was analyzed using both descriptive and inferential statistics. Descriptive statistics included frequency distribution and percentages. This was then followed by inferential statistics such as correlation analysis and multivariate regression analysis. Inferential statistics helped the researcher to establish the relationship between the independent variables and the dependent variables. The study applied a 95% confidence level. A 95% confidence interval indicates a significance level of 0.05.

RESEARCH FINDINGS AND DISCUSSION

4.1 Financial products as a determinant of customer retention

The researcher wanted to identify the relationship between the financial products and the customer retention in commercial banks. Table 4.1 illustrated the results.

Table 4.1 Relationship between financial products and customer retention

		size	Customer Retention
Size	Correlation	1	-.195
	Sig. (2-tailed)		.038
	N	60	60
Customer Retention	Correlation	-.195**	1
	Sig. (2-tailed)	.038	
	N	60	60

The correlation represented in the Table 4.1 is negative, and the value of – 0.195 is significantly different from 0 because the p-value of 0.038 is less than 0.10. The results therefore indicated that financial products must be incorporated with other factors in commercial banks for customer retention. Financial products alone cannot be relied upon in determining the financial factors affecting customer retention in commercial banks.

4.2 Online services as a determinant of customer retention

The researcher wanted to identify the relationship between the online services and the customer retention in commercial banks. Table 4.2 illustrated the results.

Table 4.2 Relationship between online services and customer retention.

		size	Customer Retention
Size	Correlation	1	-.277
	Sig. (2-tailed)		.005
	N	60	60
Customer Retention	Correlation	-.277**	1
	Sig. (2-tailed)	.005	
	N	60	60

The correlation represented in table 4.2 is negative, and the value of – 0.277 is significantly different from 0 because the p-value of 0.005 is less than 0.10. The results therefore indicated that online services must be incorporated with other factors in commercial banks for customer retention.

4.3 interest rates as a determinant of customer retention

The researcher wanted to identify the relationship between interest rates and the customer retention in commercial banks. Table 4.3 illustrated the results.

Table 4.3 Relationship between interest rates and customer retention.

		size	Customer Retention
Size	Correlation	1	.344
	Sig. (2-tailed)		.000
	N	60	60
Customer Retention	Correlation	.344**	1
	Sig. (2-tailed)	.000	
	N	60	60

The correlation represented in the Table 4.3 is positive, and the value of 0.344 is significantly different from 0 because the p-value of 0.00 is less than 0.10. This indicates that apart from interest rates, the industry should also consider other factors affecting the customer retention.

4.4 Bank charges as a determinant of customer retention

The Table 4.4 illustrated the results.

Table 4.4 Relationship between bank charges and customer retention.

		size	Customer Retention
Size	Correlation	1	.190
	Sig. (2-tailed)		.022
	N	60	60
	Correlation	.190**	1
	Sig. (2-tailed)	.022	
Customer Retention	N	60	60

The correlation represented in the Table 4.4 is positive, and the value of 0.190 is significantly different from 0 because the p-value of 0.22 is less than 0.10. The results therefore indicated that bank charges must be incorporated with other factors in the industry in order to assess customer retention in commercial banks.

4.5 Regression Results

Table 4.5 Regression Results

Model	Beta	Std. Error	t-statistic	p-value
(Constant)	1.034	.35	2.954	.005
Financial products	-.195	.092	-2.126	.038
Online services	-.277	.094	-2.953	.005
Interests rates	.344	.090	3.822	.000
Bank charges	.190	.080	2.360	.022

Dependent variable is customer retention

F=> 86.189 P=0.000 Adjusted R-squared=0.741

The regression model is

$$Y = 1.034 - 0.195 X_1 - 0.277 X_2 + 0.344X_3 + 0.190 X_4 + \varepsilon$$

Standard Error	0.35	0.920	0.094	0.090	0.080
t-Statistics	2.954	-2.126	-2.953	3.822	2.360
p-value	0.005	0.038	0.005	0.000	0.022

Where; Y = Customer retention, X1 = Financial products , X2 = Online services ,X3 = Interest rates , X4 = Bank charges, ε = Error Term, β_0 = Constant Term, $\beta_1, \beta_2, \beta_3, \beta_4$ = Beta Coefficients

4.6 Financial product

From the results presented in table 4.5, the regression coefficient of financial products was found to be - 0.195. This value depicted that holding other variables in the model constant, an increase of financial product by one unit causes the tendency of customers to leave the bank to reduce by 0.195 units. This value make economic sense since increase in available product to customers enables the bank to retain customers. The negative sign of the coefficient is also supported by the nature of the constructs used since they measured the tendency of customers to leave the bank. The coefficient was not only negative but also statistically significant with a t-statistic value of - 2.126. In social sciences a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found to be 0.092 and the p-value was found to be 0.038 which is a value below the critical value 0.05. The influence of this variable was the second least. These results support those of (Stewart, 2013), Al-Ethawi *et al.*, (2014), (Brennant and Ritch, 2010) and Gautam (2012) who found that financial innovation determine customer retention

4.7 Online services

From the results presented in table 4.5, the regression coefficient of online services offered by the bank was found to be - 0.277. This value depicted that holding other variables in the model constant, an increase of online services by one unit causes the tendency of customers to leave the bank to reduce by 0.277 units. This value make economic sense since increase in available online platform services to customers enables the bank to retain customers. The negative sign of the coefficient is also supported by the nature of the constructs used since they measured the tendency of customers to leave the bank. The coefficient was not only negative but also statistically significant with a t-statistic value of -2.953. In social sciences a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found to be 0.094 and the p-value was found to be 0.005 which is a value below the critical value 0.05. This variable was the second most influential. These results support those of (Singh, 2014; Mishra and Singh, 2014), (Liang *et al.*, 2008), Bangladesh, Morad (2012) and Wong *et al.* (2013) who found that online services determine customer retention.

4.8 Interest rates

From the results presented in table 4.5, the regression coefficient of interest rate in the banks was found to be 0.344. This value depicted that holding other variables in the model constant, an increase of interest rate by one unit causes the tendency of customers to leave the bank to

increase by 0.344 units. This value make economic sense since increase in interest rate reduces the ability of customers to borrow from the bank. This consequently reduces the ability of the banks to retain customers. The positive sign of the coefficient is also supported by the nature of the constructs used since they measured the tendency of customers to leave the bank. The coefficient was not only positive but also statistically significant with a t-statistic value of 3.822. In social sciences a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found to be 0.090 and the p-value was found to be 0.000 which is a value below the critical value 0.05. This variable was the most influential. These results support those of (Francis, 2007), (Moore and Craigwell, 2009; Moore and Craigwell, 2009) and Paciello *et al*, (2013) who found that interest rates determine customer retention.

4.9 Bank charges

From the results presented in table 4.5, the regression coefficient of bank charges in the banks was found to be 0.190. This value depicted that holding other variables in the model constant, an increase of bank charges by one unit causes the tendency of customers to leave the bank to increase by 0.190 units. This value make economic sense since increase in interest rate reduces the ability of customers to borrow from the bank. This consequently reduces the ability of the banks to retain customers. The positive sign of the coefficient is also supported by the nature of the constructs used since they measured the tendency of customers to leave the bank. The coefficient was not only positive but also statistically significant with a t-statistic value of 2.360. In social sciences a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found to be 0.080 and the p-value was found to be 0.022 which is a value below the critical value 0.05. This variable was the most influential. These results support those of (Gweyi, 2013), , (Brennant and Ritch, 2010) (Doucouliagos and Stanley, 2013), (Eppie, 2007), Msoka and Msoka (2014) and (Boohene *et al*, (2013) who found that bank charges determine customer retention.

5.0 Summary of the findings

The financial products were found to have effect on the customer retention as depicted by the various responses from the respondents that were presented graphically. The constructs were found to be of good reliability that allowed the researcher to proceed to the inferential analysis. This variable was found to have a negative effect on the measures of customer retention. This

meant that increase in financial product innovations helped to reduce the tendency of the customers to leave the bank they are associated with.

The measurers of the on-line services were found to have effect on the customer retention as depicted by the various responses from the respondents that were presented graphically. The constructs were found to be of good reliability that allowed the researcher to proceed to the inferential analysis. This variable was found to have a negative effect on the measures of customer retention. This meant that increase in use of online services helped to reduce the tendency of the customers to leave the bank they are associated with.

The interest rates were found to have effect on the customer retention as depicted by the various responses from the respondents that were presented graphically. The constructs were found to be of good reliability that allowed the researcher to proceed to the inferential analysis. This variable was found to have a positive effect on the measures of customer retention.

On the other hand, bank charges were found to have effect on the customer retention as depicted by the various responses. The constructs were found to be of good reliability that allowed the researcher to proceed to the inferential analysis. This variable was found to have a positive effect on the measures of customer retention. This meant that increase in bank charges helped to increase the tendency of the customers to leave the bank they are associated with.

5.1 Conclusion

The study concluded that financial products in Kenya have influence on customer retention in commercial banks. The findings that innovations in financial products have a negative effect on customers' tendency to leave the bank was a good indication that financial innovations help to retain the customers in the banks. This variable was found to have a statistically significant effect on customer retention. The influence of this variable was second last influential variable in customer retention in commercial banks.

From the qualitative analysis credit card, debit cards, automatic teller machine, personal loans and mortgage facilities were also found to be key determinants of customer retention in commercial banks. These conclusions are similar to those of (Stewart, 2013), Al-Ethawi *et al.*, (2014), (Brennant and Ritch, 2010) and Gautam (2012) who found that financial innovation determine customer retention

5.2 Recommendation

Since this variable was found to be a key determinant of customer retention, commercial banks should keep a keen track on it to make sure that its effect is monitored. Commercial banks should

also come up with more products innovations since this variable was found to reduce the tendency of the customers to leave the organization and enhance customer retention. From the findings it was noted that financial product innovations such as credit and debit cards, automated teller machines, personal loans and mortgage had a great contribution to customer retention. Since the results showed that financial products and services help retain customers by reducing their tendency to leave, managers and the other stakeholders are advised to come up with new products and technological innovations that increase the number of products available to the customers. The commercial banks should also avail these products close enough to the customers even in the regions where they do not have major bank branches. The industry should also set aside resources to help in educating the customers about the availability of these products and the new ones.

5.3 Area for further research

Future research should be directed towards identifying more variables that affect customer retention in the banks. A good example is the customer relation management, marketing strategies and customer satisfaction. From the regression model it was noted that the variables included were only able to explained 74% of the variation in customer retention in commercial banks. This study therefore recommends the improvement of this model by including more variables that are relevant in explaining the variation.

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