CHAPTER III

THEORETICAL PERSPECTIVE: CUSTOMER LOYALTY

Nowadays in business environment, competition has intensified particularity in the insurance sector, mainly because of the deregulation policy and technological development of Ethiopia. Together with the increased competition, companies have encountered difficulties in selling their products, and thus also, in keeping their existing customers. It has become more difficult for them to attract and retain customers in both public and private insurance sector. It’s obvious that prosperity and survival of companies depends on their customer base, the more companies able to retain their current customers, the more they will be succeed in long-term. Due to this, the emphasis of global insurance sector has shifted from short-term and transactions focus to longer-term and relational focus. Among many of the benefits of relational approach to marketing, one prominent strategy can be considered the development of customer loyalty.

The objective of this chapter is to theoretically position this research by understanding relationship marketing and its impact on customer loyalty in relation to research objectives as background. Thus, this chapter discusses the literature concerning existing theory on ‘Relationship Marketing’ in general and its contribution to loyalty. Then, current literature on customer loyalty is discussed, including an investigation of its behavioral and attitudinal determinants and characteristics in the insurance sector. Finally, the research model presents. Thus, the flow of this chapter depicts in the figure below.
3.1. Evolution of Relationship marketing & its contribution to customer loyalty

3.1.1. Psychological perspective of Relationship.

There are various types of relationships among people such as friend, work, dating & marriage, and business relationships. Business Dictionary defines business relationship as an association between individuals or companies entered into for commercial purposes and sometimes formalized with legal contracts or agreements. Marketing literatures revealed that relationships are as long as mankind. JC Penney proverb goes on “every great business is built on relationships”. Roger et al (2011) indicates that business men of yesteryears relied on relationships for their success. In the early 1990s the concept of relationship marketing was introduced to retain and reward the existing customers than running after new customers. Reichheld (1993) postulates building closer relationship with customers resulted in better returns to companies through increased use of company services by loyal customers and referrals by satisfied customers that brought new customers.
Social psychology, which is the scientific study of how people's thoughts, feelings, and behaviors are influenced by the actual, imagined, or implied presence of others, offered theories on relationships as:

1. **Attraction theory** (Aroson, 1980): postulates that one is attracted to others on the basis of: Physical appearance and personality, Proximity (liking others who are physically close to us), Similarity (liking others who are like us), familiarity (liking those who have frequent contact with us), reciprocity (liking others who like us) and barriers (liking others we cannot have). According to this theory of attraction, if a relationship gives us more reward and pleasure than cost and pain, we will like that relationship and wish it to continue. As so, customers can be attracted to insurance product based on their convenient choices as their trust on the company, physical attractiveness of the company & service quality offered.

2. **Social exchange theory** (Thibault & Kelley, 1959): posits that all human relationships are formed by the use of a subjective cost-benefit analysis and the comparison of alternatives that people develop relationships, which yield the greatest profits. When costs exceed rewards people seek to dissolve relationship. Relationship marketing theory maintains that consumers enter into relational exchanges with firms when they believe that the benefits derived from such relational exchanges exceed the costs.

3. **Equity theory** (Messick & Cook, 1983): holds that people develop and maintain relationship in which rewards are distributed in proportion to costs. When share of rewards is less than what is demanded by equity people are likely to experience dissatisfaction and exit relationship.
These relationship theories indicate the benefits of creating relationships with customers which leads to building of customer loyalty. The purpose of building relationships with customers is to retain customers in the existing company. And by retaining them the loyalty is created and loyalty intern, results in superior long-term financial performance. Loyalty is the biased behavioral response expressed over time by customers with respect to one provider out of many providers accompanied by a favorable attitude. Any insurer should be understandable essence of relationship in order to build customer loyalty. Relationship will dissolve if mutual benefits can’t secure. Such theories can be used for better understanding how customers may initiate in the creation of customer loyalty through relationship.

Despite such a significant effort, the marketing literature has overlooked the role of equity (Szmigin and Bourne, 1998; Tax, Brown and Chandrashekaran, 1998 cited in Maria et al 2010) in developing customer loyalty. Social exchange theory and social psychology studies (Homans, 1961; Blau, 1964; Austin, McGinn and Susmilch, 1980 cited in Maria et al 2010) have shown that equity perception derives from the proportionality between the “outputs (benefits)/inputs (costs)” ratios experienced by a part (e.g., the customer) and a counterpart (e.g., the firm).

Moreover, according to social identity theory, people tend to classify themselves into different social categories. That leads to evaluation of objectives and values in various groups and organizations in comparison with the customer’s own values and objectives. They prefer partners who share similar objectives and values. (Ashforth et al. 2001). Sussmann and Vechio (1982) offered Identity-related dispositions as an antecedent of behavioral intentions which relate in turn to overt behavior. Such dispositions include social
attachment to the organization, such attachment being akin to organizational commitment. Insurers can draw lessons from social identity theory to inspire customers in the realm of creating and maintaining relationships, because relationships is seen as mediated by such and other factors.

### 3.1.2. Theory of Relationship Marketing.

To inform this crucial and foundational concept—theory of relationship marketing, this text evaluates three viewpoints. First, it presents definition of relationship marketing. Second, it shows relationship marketing developments and then it compares relationship marketing with related marketing areas. Finally, a shift to relationship marketing is presented.

Relationship marketing is defined as: identifying and establishing, maintaining and enhancing long–term relationships with customers and other stakeholders, at a profit, so that the objective of all parties involved are met and that this is done by a mutual exchange and fulfillment of promises (Gronroos, 1996). According to this definition relationship marketing focuses on maintaining a continuous relationship with customers through mutual exchange and fulfillment of promises at the expense of mutual benefits. Similarly, Berry defined relationship marketing as attracting, maintaining, enhancing, and commercializing customer relationships, so that the objectives of the parties involved are met (Berry, 1983 cited at Gidhagen. M, 1998).

Although marketing practices can be traced back as far as 7000 B.C (Carratu 1987), the evolution of relationship marketing was gradual (Mohamed H & Sagadevan 2008) as at the beginning the concentration was only on consumption. So that human activities were confined to consuming whatever was available within their reach. Then the concentration slowly moved to production. Again production was performed initially for consumption only.
and for exchange. In due course production activities extended to produce things for both consumption and for sales. During the sales era, production was performed exclusively for sales and the attention was on products. Whatever was produced became saleable because of limited supply. As the attention shifted to production, selling became a tough job because of increased supply. This made organization to move towards marketing and related activities. It is at this stage the focus was shifted from products to customers. Understanding and fulfillment of customer needs became imperative for successful survival in the market. Customers started gaining more and more attention due to the availability of unlimited brand choice. Thus, the emergence of customer driven organizations, keeping customers as their focal point took place. Intensified competition led to frequent brand switching. Organizations find it very difficult and challenging to retain customers. Then, relationship marketing has emerged as a new approach enabling marketers with brand new tools and techniques to acquire retain and expand their customer base.

In nutshell, Wikipedia, the free encyclopedia (12 Sep.2012) marketing orientations classified as five competing concepts under which organizations can choose to operate their business: the production concept, the product concept, the selling concept, the marketing concept, and the holistic marketing concept.
Table 3.1 The Marketing Orientation.

<table>
<thead>
<tr>
<th>Orientation</th>
<th>Profit driver</th>
<th>Time frame</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Production</td>
<td>production</td>
<td>Until 1950s</td>
<td>A firm focusing on a production orientation specializes in producing as much as possible of a given product or service.</td>
</tr>
<tr>
<td>2. Product</td>
<td>Quality</td>
<td>Until 1960s</td>
<td>A firm employing a product orientation is chiefly concerned with the quality of its own product.</td>
</tr>
<tr>
<td>3. Selling</td>
<td>selling</td>
<td>1950s-1960s</td>
<td>A firm using a sales orientation focuses primarily on the selling/promotion of a particular product, and not determining new consumer desires. It involves a firm essentially basing its marketing plans around the marketing concept, and thus supplying products to suit new consumer tastes.</td>
</tr>
<tr>
<td>4. Marketing</td>
<td>Needs &amp; wants of customers</td>
<td>1970 to present</td>
<td>Looks at marketing as a complex activity and acknowledges that everything matters in marketing - and that a broad and integrated perspective is necessary in developing, designing and implementing marketing programs and activities.</td>
</tr>
<tr>
<td>5. Holistic</td>
<td>Everything matters</td>
<td>21st c.</td>
<td>Looks at marketing as a complex activity and acknowledges that everything matters in marketing.</td>
</tr>
</tbody>
</table>

Similarly, Steven (2010) classified the marketing evolution into five eras (refer fig. 3.2 below). The first era is known as simple trade era where everything available was made/harvested by hand and available in limited supply and lasted until mid 19th century. The simple trade era was replaced by production era at the time of industrial revolution. This era is characterized by mass production, ‘if you build it they will come’. The next one is sales era which is characterized by ready sale everything they produced. And then department era emerged where business consolidated into marketing related...
activities (advertisement, sales, promotion, etc.) into a single department. Then the marketing company emerged which is characterized by addressing customer needs and consider customers as king. The 6th era is relationship marketing and its goal is to build long-term mutual beneficial relationship with customers. The focus changed to customer loyalty. The “loyalty management guru,” Frederick Reichheld, proposed accordingly that profit is not the primary goal. Although indispensable, profit is the consequence of value creation, which, together with loyalty, is the cornerstone of long-term relationships.

Researchers argue that relationship marketing represents a “paradigm shift in marketing” from its previous focus on “transactions,” in which firms use the “4P model” to manage marketing-mix variables (Sheth and Parvatiyar 2000). Relationship marketing is a form of marketing that evolved from direct response marketing; it places emphasis on building longer-term relationships with customers rather than on individual transactions. Relationship marketing involves an understanding of customers' needs and wants through their lifecycle and providing a range of products or services accordingly.

Transactional marketing attracts the customers to buy the product and walk away; on the other hand, relationship marketing takes the sale as the first step to relation building. Gidhagen.M (1998) showed the difference between transactional and relationship marketing in the table below.
Table 3.2: The Shift to Relational Marketing

<table>
<thead>
<tr>
<th>Transaction marketing</th>
<th>Relationship marketing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orientation to single sales</td>
<td>Orientation to customer retention</td>
</tr>
<tr>
<td>Discontinuous customer contact</td>
<td>Continuous customer contact</td>
</tr>
<tr>
<td>Focus on product features</td>
<td>Focus on customer value</td>
</tr>
<tr>
<td>Short time scale</td>
<td>Long time scale</td>
</tr>
<tr>
<td>Little emphasis on customer service</td>
<td>High emphasis on customer service</td>
</tr>
<tr>
<td>Limited commitment to meeting customer</td>
<td>High commitment to meeting customer</td>
</tr>
<tr>
<td>expectations</td>
<td>expectations</td>
</tr>
<tr>
<td>Quality as the concern of production staff</td>
<td>Quality as the concern of all staff</td>
</tr>
<tr>
<td>Marketing as the concern of marketing staff</td>
<td>Marketing as the concern of all staff</td>
</tr>
</tbody>
</table>

Source: Adapted from Payne et al., 1995, cited from Gidhagen M (1998)

3.1.3. Relationship marketing and its Impact on Customer Loyalty in insurance sector

According to Mohamed & Sagadevan (2008) relationship marketing is a strategy designed for fostering customer loyalty. Relationship marketing is designed to develop strong connections with customers by providing them with information directly suited to their needs and interests and by promoting open communication. Such approach often resulted in increased of customers’ word-of-mouth activities, repeat purchase and willingness on the customer’s part to provide information to the service providers.

A good relationship implies at least two fundamental conditions. First, it should be mutually rewarding to the provider and the customer (i.e., they should both benefit from the connection) and second, it involves some kind of mutual commitment over time. In
establishing and maintaining customer relations, the seller gives a set of promises that are connected with goods, services, or other benefits. In exchange, the buyer gives his or her promises and these promises must be kept on both sides in order to ensure profitable long-term business operations (Grönroos, 1990 as cited in Gidhagen, 1998). The major objective of relationship marketing is to develop long-term relationships with customers.

Conventionally, the focus of traditional marketing has been on creating new customers. This rather “offensive marketing strategy” included, in addition to acquiring completely new customers, attempting to attract dissatisfied customers away from competitors, particularly in periods of fierce competition (Storbacka et al., 1994 as cited in Hollensen and Marc, 2010).

However, relationship marketing focuses on both acquisition and retention customers. This view is generally supported by marketing scholars, many of whom further promote the concept by suggesting that customer acquisition is between five and ten times more expensive than customer retention (Reger et al., 2011). The ultimate goal of relationship marketing is to bolster already strong relationships and convert indifferent customers into loyal ones (Ndubisi, 2007). McMullen and Gilmore (2003) contend that developing and maintaining customer loyalty, or creating long-term relationships with customers, is the key to the survival and growth of firms, particularly service companies.

In relationship marketing terms, a customer is someone who has done business with the company only once or occasionally. When customers start to acknowledge a product's benefits and do business on a repetitive basis, they become “clients”. At this stage, relationship marketing is crucial in transforming clients into “supporters” (McDonald and Chirstopher, 2003). At the “supporter” stage, a special relationship between the firm and
the person becomes apparent. Supporters enjoy being associated with the company and
they may even be persuaded to become “advocates”. At the “advocate” stage, positive
word-of-mouth about the organization will occur. Lacey and Morgan (2009) added that,
advocacy customers exhibit not only repeat business, positive word-of-mouth and referrals
but, also a comprehensive willingness to help the business grow. Finally, at the top level,
the customer becomes a “partner” and will find ways in which both parties can gain mutual
benefit from the relationship. This model demonstrates that relationship marketing is based
upon finding the appropriate means to move target customers up the extended loyalty
ladder and to keep them there.

According to Uncles (1994) consumers actively seek an involving relationship with their
service supplier which in turn offers psychological reassurances to the buyer and creates a
sense of belongingness. Several writers have explored the motivations of consumers for
engaging in relational exchanges with firms. Morgan and Hunt (1994) identify
“relationship benefits” as a key antecedent for the kind of relationship partner that
characterizes consumers who engage in relational exchange. Furthermore, consumers need
relationship partners with whom they can trust. They do so because a trusted partner
reduces the risks associated with relational exchange, because trust is associated with a
partner’s reliability, integrity, and competence. Finally, Morgan and Hunt propose that
consumers are motivated to engage in relational exchanges with partners with whom they
share values. That is, they seek firms that agree with them as to what is important vs.
unimportant, right vs. wrong, appropriate vs. inappropriate, proper vs. improper, and
significant vs. insignificant. For example, some consumers will engage in relational
exchanges only with those firms that they deem to be socially responsible. Second, Sheth
and Parvatiyar (1995, p. 256) propose that consumers engage relational market behavior to achieve greater efficiency in their decision making, to reduce the task of information processing, to achieve more cognitive consistency in their decisions, and to reduce the perceived risks associated with future choices.

3.2: The need of customer loyalty in insurance sector

Wikipedia, the free encyclopedia (20 July 2013) defines insurance as: A promise of compensation for specific potential future losses in exchange for a periodic payment. Insurance is designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss. Some forms of insurance are required by law, while others are optional. Agreeing to the terms of an insurance policy creates a contract between the insured and the insurer. In exchange for payments from the insured (called premiums), the insurer agrees to pay the policy holder a sum of money upon the occurrence of a specific event. In most cases, the policy holder pays part of the loss (called the deductible), and the insurer pays the rest. Examples include car insurance, health insurance, disability insurance, life insurance, and business insurance.

Considering insurance services, the personal interaction between the parties is limited, and in some relationships there may not even have been a single opportunity to meet personally with the insurance agent. This requires well-educated and highly trained agents in order to maintain profitable relationships. Consequently, considering the fact that insurance services are more complex and difficult for the customer to fully comprehend.

Customer buys a service which he or she won’t actually notice until a loss is suffered. Hence, the policy holder initially consumes a service in the shape of extremely intangible risk coverage and then after some time has elapsed, when something occurs which is
covered by the insurance policy, he or she may have the “opportunity” of consuming the service in another shape. There are relevant indications that tactically applied relationship marketing strategies provide a viable solution to insurance companies in competitive distress. The competition in the insurance markets will most certainly continue to intensify.

Customers are always perhaps obvious, but still vital, key to holding a favorable position in the market, and to do so at a profit. “The customer is king” is a well-known phrase in marketing. Insurance provides promises to customers so that relationships are important.

Modern business environment is characterized as more intense competitions and companies are forced to build strong relationships with their customers to reach more profits (Ndubisi, 2007). Considerable evidence has disclosed that customer loyalty is a proxy for actual customer purchase behavior and can bring on long-term business profits. Lovelock and Wirtz (2004) define customer loyalty in business context, loyalty has been used to describe a customer’s willingness to continue patronizing a firm over the long term and recommending the firm’s products and services to friends and associates.

However, Ball et al. (2004) defined customer loyalty in two dimensions: Behavioral and attitudinal loyalty where behavior loyalty is defined as repeated transactions and it can be simply measured with observation approach. Attitude loyalty is defined as positive affect for relationship and desire for retaining relationship continuance. Bowen and Shoemaker (1998 as cited in Nana c Wei, 2010) suggest research on behavior loyalty can show the customer preference for a brand or product. So that Alinvi & Babri (2007) suggest customers’ preferences change on a constant basis, and organizations should adjust in order to meet these changes to remain competitive and profitable.
Nowadays it becomes reality that relationships are considered as the basis of business. That is why marketers are heard saying building customer loyalty is a key to profitability, so that it is imperative to develop long-term relationships with customers. A recent global insurance survey (Ernst & Young, 2012) stated that across all markets, ease of purchase and trust in the providers are the dominant reasons for purchasing additional products from the existing provider. According to this survey, on average (43%) of consumers said that it is easier to buy from a known provider, while (42%) of respondents replied, they would repeat purchase from a trusted source. This shows the importance of relationship between customers and insurers, but the creation of this sense of loyalty is not something that happens overnight. It takes time. The “loyalty management guru,” Frederick Reichheld (1996) proposed that profit is not the primary goal. Although indispensable, profit is the consequence of value creation, which, together with loyalty, is the cornerstone of long-term relationships. An enhanced level of customer loyalty includes the benefits of increased revenues from repeat sales and referrals. Loyal customers also become less price sensitive. Peter Maas (2008) differentiate insurance customers into five which is described below

**Insurance customers differs one to the other**

According to Peter Maas (2008) research result, customers “think” about insurance differently and want to be treated in different ways. Insurers have been trying to cope with this diversity by using specific marketing campaigns to target select customer segments, based mainly on socio-economic parameters like age or income.

Ernst & Young Global insurance survey (2012) argue that some customers need cheapest offer, or looks for convenience and service, or is open to usage-based insurance. IBM
Global Services (2008) showed that offerings depend on his or her specific patterns of attitudes and value perceptions. The overall spread of these patterns is determined by cultural and national differences.

According to Peter Maas (2008), customers can be grouped into five different segments or types of customers, depending on their general attitudes and value drivers: support-seeking individualists, product optimizers, uninterested minimalists, price-sensitive analyzers, and relationship-oriented traditionalists. Some customers need advisors whom they can trust, like the individualists and traditionalists; others primarily look for excellent products (optimizers) or hunt for good prices (analyzers). These customer types do not just represent the wide range of different value perceptions in the market, they also give a clear indication of the required corresponding success factors for the value propositions insurers should supply. For example, price-sensitive analyzers expect – apart from the best value for the money – to find a high level of transparency, as well as the relatively sophisticated use of technology to achieve this transparency. The meaning and use of each single success factor – trust, transparency, and technology – differ by customer type. Minimalists expect technology to allow them quick and infrequent touch points with insurers, while analyzers have a tendency to see it as a means for comparing and doing cost-efficient business. Optimizers, on the other hand, are more willing to have insurers use technology in the actual product, for example, data submission as part of a usage-based insurance offering. Similar distinctions also apply for trust and transparency: for individualists and traditionalists the focus is on personal trust, while optimizers need trust in the product and the institution that offers this product.
3.3: Drivers of Customer loyalty in insurance sector

According to Zineldin (2006) customer loyalty is a customer commitment to continue to do business with particular firm on an on-going basis. Loyalty has two dimensions – behavioral loyalty and attitudinal loyalty (Lam & Burton, 2006). Behavioral loyalty can be measured by frequency of purchase or word of mouth that is to say; loyal customers are those buying different policies from the same provider. From this point of view loyalty is easy to measure. A policyholder who bought many different policies from the same company could renewal contracts. Attitudinal loyalty is the feeling of attachment, psychological bonding, and linkage to one provider.

This study employs both behavioral measures (as purchasing different policies from the same insurer and word of mouth, telling for others the reputation of the insurer) and attitudinal loyalty (the level of psychological attachment to the insurer). The insurance industry is facing myriad business challenges brought on by a volatile economy: Diminishing investment returns, increasing claims, intense competition and the declining customer loyalty are continually eroding insurers’ profitability.

Therefore, in order to maintaining customer loyalty derivers of customer loyalty should be examined and resources should be deployed for the sustainability of loyalty. Thus, antecedents of customer loyalty are discussed in the following paragraphs.

i. Customer trust

Trust by a customer is certainly more important for an insurance company than any other type of business because insurers are selling promises. Morgan and Hunt (1994) see trust as the confidence that one partner has in the other’s reliability and integrity. Trust is seen as a fundamental relationship building block. Most definitions of trust involve a belief that
one relationship partner will act in the best interest of the other partner (Wilson, 1995). Daily monitor (2013) revealed that insurance sales a service which is abstract in nature and without trust, the industry can’t grow. This makes customer trust a cornerstone of the insurance services industry.

The main benefit of trust is customer loyalty, which in turn leads to a longer-term relationship, greater share of wallet, and higher advocacy or word-of-mouth. A survey conducted to know the role of trust in customer relation, made interview with senior business marketing executives’ revealed the importance of trust as:

For us, trust is the Holy Grail, its importance is 11 out of 10, we are saying to our customers, ‘trust us with your future’ (Halliburton & Poenaru, 2010).

Moreover, researchers have stated, trust is fundamental in developing customer loyalty (Morgan & Hunt, 1994). Asian –Pacific insurance survey (Ernst & Young, 2012) claimed that (42%) of the respondents buy different policies from the same provider due to trust on the company. This means the more customer has trust on the providers the more will be loyal to the provider.

ii. Switching cost

Ping (1993) found that when customers perceive switching costs to be high (associated with leaving the current relationship and establishing a new one), they tend to be loyal. Whenever a customer shrink a business to another, undertakes some costs. It is the barriers that influence customer decision to change a provider. Switching cost includes the technical, financial, and psychological costs that make it difficult or costly for customers to change brands (Zhang and Feng, 2009, p.19).

As defined by Jones et al., (2002), a switching barrier is any factor that makes it difficult or costly for customers to change providers. Another brand loyalty determinant is known
as switching costs, which can be defined as the technical, financial or psychological factors which make it difficult or expensive for a customer to change brand (Shergill and Bing, 2006).

For this reason, a switching cost can be seen as a cost that deters customers from demanding a rival firm's brand (Aydin and Ozer, 2005). It can be defined as the technical, financial or psychological factors which make it difficult or expensive for a customer to change brand (Selnes, 2007). When the costs of switching brand are high for the customer, there is a greater probability that the customer will remain loyal in terms of repeat purchase behavior, because of the risk or expense involved in switching and because of the accompanying decrease in the appeal of other alternatives (Kon, 2004).

While customer satisfaction may be one important driver of customer retention, switching costs are also likely to influence customer retention, both independently and in tandem with customer satisfaction (Ranaweera and Prabhu, 2003). For example the presence of switching costs can mean that some retained customers that are apparently satisfied are actually dissatisfied but don’t switch insurance because of high switching costs. Wong chi B (2011) made a research and confirms that switching costs and customer satisfaction are positively affect customer loyalty.

A more specific description is presented by Jones and Sasser (1995 as cited in Wong chi B 2011) by classifying customers into four different groups as depicted below in figure 3.4.
According to the above figure, “Apostles” (high satisfaction - high loyalty) are those who are not only loyal, but so satisfied that they recommend the product or service to others. “Hostages” (low satisfaction - high loyalty) are strongly dissatisfied, but have few or no alternatives. “Mercenaries” (high satisfaction - low loyalty) are those who want to change supplier in order to obtain lower prices although they experience high customer satisfaction. “Terrorists” (low satisfaction, low loyalty) have used alternative suppliers, and do not miss an opportunity to express their dissatisfaction with their former supplier. If switching costs are low, we should find very few (hostages, since dissatisfaction should result in changing providers. But we are likely to find many mercenary customers who are satisfied but disloyal because low switching costs make switching easy. In contrast, if switching costs are high, we are likely to see many false loyal customers; though they are dissatisfied, switching costs make them less likely to switch. But we are unlikely to see mercenaries since high switching costs make them less likely to change providers when they are satisfied.

Switching costs become important when there are at least a few viable alternative providers of the service in a market. If this criterion is met, switching costs will affect the
existence of the off-diagonal groups in the Jones and Sasser (1995) matrix. Thus, if switching costs are low, we should find very few false loyal (hostages), since dissatisfaction should result in changing providers. But we are likely to find many mercenary customers who are satisfied but disloyal because low switching costs make switching easy. In contrast, if switching costs are high, we are likely to see many false loyal customers; though they are dissatisfied, switching costs make them less likely to switch. But we are unlikely to see mercenaries since high switching costs make them less likely to change providers when they are satisfied. Lee et al. (2001) stated that customer loyalty may be due to satisfaction or it may be due to dissatisfaction in a product category in which relatively high switching costs make it more difficult for customers to change providers. This means that in tandem with satisfying customers, companies should develop strategies to retain dissatisfied customers using switching cost.

The switching cost is a main factor having effect on the customer retention. As the switching cost increases, risk and burden on consumers are increased in the customer side and dependency on the service provider gets increased as a result (Jones et al., 2000). This means the more customers recognize switching costs the more commitment to stay in the company. The higher switching costs are positively related to customer loyalty (Ping 1993). Switching costs represent any factor that makes it more difficult or costly for consumers to change providers.

iii. Service quality, customer satisfaction and customer loyalty.

The customer service delivery function is focused on satisfying customers, which leads to creating customer loyalty (Roger et al., 2011). Furthermore, Bhattacharjee (2006) in his “service marketing book” revealed a service–profit chain model which is depicted below.
Figure 3.3: Service-profit chain Model (adapted from Bhattacharjee (2006))

As it is clearly shown in the above figure profit and growth are linked to customer loyalty. Customer loyalty is linked to customer satisfaction and customer satisfaction is linked to service quality. Similarly, Johnson & Gustafsson(2006) developed service quality - satisfaction-loyalty model as depicted below.

Figure 3.4: A frame work for linking service quality to loyalty.

The figure above shows service quality is linked to loyalty directly and indirectly. According to the above figure quality service offered to customers can make them to be satisfy and can lead them to be loyal to the company. Ehigie (2006) suggests that there is a significant positive relationship between service quality, customer satisfaction and customer loyalty/retention. This means companies should have to offer quality service
(meeting their needs) to their customers and must be able to satisfy and retain customers Because that is the key to its business performance.

In spite of this, Kumar and W.J. Reinartz(as cited in Roger et al., 2011 p.136) claimed that the link between customer satisfaction and customer loyalty is asymmetric (dissatisfaction has a greater impact on loyalty than satisfaction). Roger et al., (p.130) pointed out that dissatisfied customers tell more people about their bad experience than satisfied customers with good experiences. Moreover, some researchers point out that customer satisfaction played a mediation role between service quality and customer loyalty link. Thus, its role as mediation effects is described in the following paragraphs.

Before diving in the detail about mediation effect the concept of mediation and moderators should be clear. Mediators are different from moderators so that it is important to understand between the two. A moderator is an independent variable that affects the strength and/or direction of the association between another independent variable and an outcome variable (Baron, R.M., & Kenny, D.A. 1986). Figure 3.7 below illustrated a moderator effect.

![Figure 3.5: The effect of moderator variable](image)

Age is an independent variable or (moderator) which influences the strength of a relationship between customer satisfaction and the outcome customer loyalty in insurance companies. In the relation between customer satisfaction and customer loyalty older people could be stronger than youngsters. Thus, the effect of the intervention on the outcome depended on the level of the moderator (Baron, & Kenny, 1986). On the other hand, a mediator is a variable that specifies how the association occurs between an
independent variable and an outcome variable. A mediator variable is one that explains the relationship between the two other variables (Baron, & Kenny, 1986). The figure below shows the mediation effect.

![Mediation variable effect](image)

As the figure above shows, customer satisfaction is a mediator variable in that it explains why there is a relation between service quality and customer loyalty. When you remove the effect of customer satisfaction, the relation between service quality and customer loyalty will disappear.

Mediator-oriented research is usually concerned with the mechanism of the relationship between the independent variable and the outcome variable. In other words, the "how" and "why" is more interesting to the researcher than the independent variable itself. In contrast, a researcher who includes a moderator in the model wants to know "when" the relationship occurs between the independent and outcome variables (Baron & Kenny, 1986). Mediator relationships are causal relationships so that it is necessary to assess other causal relationships for more understanding. Thus, different types of relationships are presented in the figure below for exemplifications. Types of causal relationships identified by Jaccard & Turrisi (2003, cited Henseler & Fassott 2010) that can occur within causal models. The figure below illustrated the symbolic representations of the different causal relationships.
.1. Direct causal Relationship

.2. Indirect (or Mediated) Causal Relationship

.3. Spurious relationship

.4. Bidirectional Causal Relationship

.5. Moderated Causal Relationship

Figure 3.7: Casual relationships, (adapted from Jaccard and Turrisi (2003, p. 2 as cited in Henseler & Fassott 2010)

The above symbolic representation indicate as: Direct effects when an independent variable, X, causes a dependent variable, Y; Indirect effects (also called mediating effects) when an independent variable, X, has an impact on a third variable, Z, which then influences the dependent variable, Y; Spurious effects when a correlation between two variables stems from a common cause, Z; Bidirectional effects when two variables, X and Y, influence each other; Unanalyzed effects; and moderating effects (also called interaction effects) when a moderator variable influences the strength of the direct effect between the independent variable, X, and the dependent variable, Y. Once a relationship between two variables is established, it is common for researchers to consider the role of other variables in this relationship (Lazarsfeld, 1955). The table below illustrates three types of mediation relationships.
1. **Indirect effect**

The independent variable affects the mediator and the mediator affects the dependent variable. IV does not affect DV directly.

2. **Partial mediation**

The independent variable affects the dependent variable, and also the dependent variable related to mediation variable. In turn the mediation variable influences the dependent variable.

*Figure 3.8: Types of mediation (adapted from Baron & Kenny 1986)*

Wikipedia Free encyclopedia (July 2013) pointed out that Partial mediation maintains that the mediating variable accounts for some, but not all, of the relationship between the independent variable and dependent variable. Partial mediation implies that there is not only a significant relationship between the mediator and the dependent variable, but also some direct relationship between the independent and dependent variable. Baron and Kenny (1986) asserted that the evidence for mediation is strongest when there are both indirect and direct effects; they call it “partial mediation.”

3. **Full mediation**

Independent variable affect directly the mediator, the mediator in turn affect the dependent variable. The effect of dependent variable to the dependent variable is insignificant.

*Figure 3.9: Full mediation (adapted from Baron & Kenny 1986).* Adapted from: Baron, & Kenny, (1986).
Reasons for studying the relationship between service quality to customer loyalty through mediation of customer satisfaction is that:

(1) Service quality directly influences customer loyalty

(2) Service quality affects customer satisfaction and customer satisfaction impact customer loyalty (refer review literature). Therefore, three conditions should be met for partial mediation to be exist (Baron & Kenny 1986).

1. The relation between service quality and customer loyalty

The independent variable affects the dependent variable customer loyalty, thus the first condition is fulfilled.

2. The relation between service quality and customer satisfaction.

Service quality affects customer satisfaction, the correlation between service quality and customer satisfaction treats customer satisfaction (mediator) as if it were a dependent variable, thus the second condition is met.

3. The relationship between customer satisfaction and customer loyalty

It might be helpful to mention one empirical evidence as an example to show that the service quality and customer loyalty and customer satisfaction to customer loyalty relations are theoretical and empirically valid for strengthening this idea. Bloemer, et al. (1998 as Cited in Osman & Ramayah, 2010) have presented a model to show how the mental picture, service quality, and customer satisfaction influence customer loyalty. Findings of this research show that the mental picture indirectly and through service quality, influences loyalty. On the other hand, service quality influences loyalty both directly and indirectly (through satisfaction). Though, customer satisfaction (mediator) affects customer loyalty
the dependent variable, thus the third condition is met. This shows that a partial mediation can be established.

![Figure 3.10: The partial mediation of customer satisfaction on service quality to customer loyalty link.](image)

Often better services lead the customer to believe that the provider is trustworthy or dependable. In other circumstances, simply the perceived quality of service may help the service providers to gain the confidence of the customer (Singh & Sirdeshmukh, 2000). The main factor determining customer satisfaction is the customers’ own perceptions of Service quality (Zeithamal & Bitner, 1996) and perceptions of service quality affect the feeling of satisfaction, which in turn influences future purchase behavior (McDougall & Levesque, 2000).

Impact of satisfaction on loyalty is researched in broad terms. Many findings show that if satisfaction is there then customers are loyal and if customers are dissatisfied their loyalty is not guaranteed. Hence management should pay special focus on the satisfaction of a customer and for it service quality is plays a vital role (Akbar and Parvez et al., 2009).

In addition to, Peter Maas (2008) based on his survey revealed that many people are disappointed with the service quality of insurance firms in Uganda either due to failure to pay their claims on time or going through lengthy procedures. The bad experiences have forced many to shun insurance; thus, the low penetration levels, now at 0.65 per cent, the
lowest in East Africa. Drawing on the above-mentioned literature and theoretical reviews the following research hypothesis is developed. The theoretical model guiding the investigation is depicted in figure below, derived from literature review

![Figure 3.1: The conceptual Model](image)

The above model shows that underpinnings of antecedent variables affect customer loyalty as the dependent variable. Service quality influences loyalty via customer satisfaction. Based on the above arguments, hypotheses (as shown in the figure) related to customers loyalty is proposed. The question of the research is: how does each determinant factors influences customer loyalty individually and simultaneously? Answers for the question will be given in latter sections.

### 3.4 Chapter Summary

The main objective of this chapter is to investigate the theoretical perspective of relationship marketing and its effect on customer loyalty. The psychological perspective of relationship and its application in marketing has been discussed. Development of technology and service marketing led to a new approach that emphasized long term and close relations with customers. Therefore transaction-based marketing that focus only on
the selling of the product shifted to relationship marketing that focus on the establishment of sustainable and long term relations with customers. Company's efforts are now to develop and maintain a close relationship with its customers to develop customer loyalty. As seen in the above text, and all other things being equal, service quality, customer satisfaction, customer trust and switching costs are thought to be key antecedents of customer loyalty. Furthermore, customer satisfaction plays a mediation role between service quality and customer loyalty link. Based on this hypothesis is developed to be tested by study.