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BANK MANAGERS ON DEVELOPING CUSTOMER RELATIONS
Abstract
Banks are known to have stable and long lasting relations with their customers, which is why development of customer relations is a crucial strategic issue in banking. However, a basic problem in banking is that the customer base is heterogeneous, ranging from homogenous segments of customers with the same preferences to customers with individual demands for customized services. A key issue in banking is thus how bank managers view different strategies to develop their customer relations. This paper investigates how bank branch managers perceive the heterogeneity of their market and how the bank’s relationship strategy affect the development of customer relations. To this end, 135 branch bank managers answered a questionnaire, which was processed by LISREL. Results suggest that how bank managers perceive customer relationship development is determined by the heterogenous market and the bank’s relationship strategy. Contrary to our expectations, bank managers consider that more difficult relationship development leads to a more centralized locus of realized strategy. This suggests that banks relationship development need to focus more on customer orientation, and that realized strategies need to support this.

Introduction
Management of business relationships is a key strategic success factor to fully utilize the market potential. The goal of relationship development has been defined as the ability to attract, maintain, and enhance new customer relations (Berry 1983). Despite its importance, this field of relationship research is underdeveloped (Berry 1995, Sheth and Parvatiyar 1995). Contributions to this area have developed a number of models for relationship management (Zeithaml, Berry and Parasuraman 1988, Grönroos 1983, Bitner 1995). A common denominator of these models is that firms need to adjust to market conditions. This involves, for instance, narrowing "perceptional gaps", to adjust workflows in the organisation, or to activate the customer as a relationship partner.

The effectiveness of such adjustments, however, depends on the exchange characteristics of the customer relationships. These characteristics have been found to be contingent on the level of trust and commitment in the relationship (Anderson and Weitz 1992, Morgan and Hunt 1994), the type of relationship coordination (Alter and Hage 1993; Anderson and Narus 1990), the kind of production technology (Hallén et al. 1991), and the degree of integration with surrounding business relationships (Anderson, Håkansson and Johanson 1994, Blankenburg Holm, Eriksson and Johanson
These findings support the fact that customer relations more often seem to be more heterogenous than homogenous.

The relationship rests on a number of value creating transformations in which the customer makes different contributions. Lengnick-Hall (1996), for instance identified five different customer contributions: customer as resource, co-producer, buyer, user, and product. The value creating transformations are embedded in a numer of different transactions that make up an individual customer relationship. Each transaction may have a unique customer contribution. Together they constitute a pattern of customer involvement. The more these patterns vary between different customers, the more heterogeneity can be expected among customer relationships.

Management of an heterogeneous customer base is problematic because it requires the firm to customize products to a wide range of different customers. In order to do this a firm needs to adjust its internal procedures and structures so that they can be flexible enough to handle different kinds of workflows (Thompson 1967, Fry 1982). Differences in workflow technology has been analyzed in terms of knowledge involved (Perrow 1967), materials used (Hickson 1969) and operations of production (Thompson 1967). The effect of technology has also been analyzed through the characteristics of its antecedents, such as information used in production (Galbraith 1973, 1994).

Another important factor for relationship development is that of the strategy of the firm which provides a rationale for how the firm relates to its market and environment (Quinn, Mintzberg and James 1988, Rumelt, Schendel and Teece 1994). To develop relationships, a firm needs an appropriate strategy for how to handle relationships, and how to develop relationships and must consequently also take account of how the strategy is to be realized (Minzberg 1994).

To develop customer relationships, then, we suggest that two major constructs be considered: the strategy of the firm and the heterogeneity of existing customer relationships. It is here hypothesized that heterogeneity and strategy affect relationship development in that heterogeneity requires a workflow organization that can handle diverse types of information; and the strategy construct includes assumptions on the kind of workflow organization the firm will use. In this study we investigate how
intended relationship strategy and relationship heterogeneity affect relationship development in the context of a retail banker. The perspective taken is that of the decision maker’s perception of customer relations development. This issue has been little researched (Berry 1995), and we intend to fill this gap in the literature on relationship management.

We will structure our paper as follows. First, we outline our hypotheses and structural model. Second, we describe data collection and statistical method. Third, results are presented. Finally, some managerial conclusions are drawn.

**Relationship Heterogeneity, Information Diversity, and Relationship Development**

Heterogeneous markets in mainstream marketing have been managed by the use of differentiated or custom marketing strategies. Customers are then grouped or handled individually when the marketer seeks to satisfy customer needs. In effect, each customer can be seen as an individual market segment. Segmentation stems from the idea of effectively using marketing efforts to generate customer sales. Recent marketing thought has re-directed its focus from managing the marketing effort to managing long-term relationships with parties that contribute to the company’s success.

Relationship development has been defined as the ability to attract, maintain, and enhance new customer relations (Berry 1983). To achieve such desirable aims, a firm needs to achieve mutual rewarding relations with customers. This is achieved through adaptation (Hallén, Johanson and Seyed-Mohamed 1990) between customer and firm. Adaptations is a way of bringing about a match between actors, for instance between how a service firm can provide services to customers, and how a customer can utilize these services. In practice this could involve the reconfiguration of the transaction to fit a certain customer contribution as discussed above (Lengnick-Hall 1996). Because of differences between firms’ in capabilities, it has proven difficult to manage relationship adaptation. One way to bridge these differences is through information exchange. For instance, it has been shown that adaptation increases with the number of persons involved in the relationship (Hallén 1986).
Adaptations effectively generates knowledge within the firm about the counterpart. This knowledge is then stored and enhances the firm’s capabilities. Information processing is a key component in the capabilities of service firms. Banking, for instance, builds its internal operations largely on information processing (Argyris 1954, Davies 1989). This may not be difficult to manage in itself, but the diversity in information content has substantial impact on the management of firms (Galbraith 1973, 1994). Different customer contributions may call for diversity of information. It is therefore expected that relationship heterogeneity has a strong effect on information diversity in firms.

Given that more diverse information is more difficult to manage, the results is that the firm has more difficulty in adapting to customers and develop relationships. We suggest the following hypotheses.

Hypothesis 1. The more heterogeneous the relationships, the more diverse the information processed in a firm

Hypothesis 2. The more diverse the information processed in a firm, the more difficulty it has in developing customer relationships.

**Intended Customer Relations Strategies, Relationship Development, and Locus of Realized Strategy**

The main focus of relationship research is on existing customer-supplier relationships. Little effort has been devoted to relationship initiation. Relationships can be dichotomized in new or established. The efforts necessary for development of the relationship will depend on whether a certain relationship belongs to the former or latter category. In services industries with strong and stable customer relations, it may be more difficult to initiate new relationships than to develop existing ones. In banking, customer relations have been observed to be stable and long-lasting. We therefore argue that industries with strong customer ties ought to display more difficult relationship development in the initial phase of the relationship, than in the subsequent relationship development phase. Therefore, relationship development should be more
difficult if the intended corporate strategy is to acquire new customers, rather than to develop the existing customer base.

Hypothesis 3. The more a firm’s strategy is focused on developing existing customers (as opposed to acquiring new customers) the less difficult will be its relationship development.

Most relationship strategies focus on the exchange of the relationship. As mentioned before, however, management of heterogeneous firm-customer relationships is a difficult task. As a working hypothesis, we now assume that managers can centralize the realized locus of strategy at the point of relationship exchange. In a situation where relationship development is easy, we expect a relationship exchange to be more standardized, and the realized strategy to be centralized and focused on efficiency in processing. In a situation where relationship development is difficult, on the other hand, we expect a realized strategy to be locally driven, since relationship exchange is non-standard and may require a high degree of adaptation. We put forward the following hypotheses.

Hypothesis 4. The more difficulty a firm has in developing relationships, the more local, as opposed to central, will be the realized firm strategy.

A Model on Strategies for Developing Heterogenous Customer Relations
Our hypotheses are put together in a model in Figure 1. We expect all four hypothesis to be interrelated in this model, meaning that none of them should be singled out of their context in the model. An additional hypothesis is thus that the four hypotheses relate to each other in the model depicted.
Figure 1. Hypothesized Structural Relations.

Data and Statistical Method
Data was gathered from 135 bank branch managers in the Stockholm area in Sweden. The response rate is 95%, since the questionnaire was dispatched to 145 managers. This unusually high response rate was achieved with cooperation from the participating bank’s top management. The branch managers were selected from Sweden’s four dominating bank groups. No selection was made in terms of size or customer base of branches, and the sample includes almost all Stockholm branches from the participating banks.

Data was processed with LISREL, which is a structural relations statistical method for studying putative structural relations (Jöreskog and Sörbom 1993). Compared to ordinary correlation techniques, LISREL has two distinct advantages. The first is the inclusion of latent variables, which are higher order variables that represent the underlying commonalities of a set of indicators (i.e. observed variables). The latent variables correspond to theoretical constructs, and will hereafter be referred to as constructs. The second advantage of LISREL is that causal relations between constructs can be studied. In forming structural relations between constructs, the gap
between theory and measurement can be narrowed. The method has found a number of approaches in the social sciences in general (Bollen 1989, Jaccard and Wan 1996, Jöreskog and Sörbom 1993, Hayduk 1987), in marketing (Anderson and Gerbing 1988), and international business studies (Blankenburg Holm et al. 1996, Eriksson, Johanson, Majkgård, and Sharma 1997).

The validity of LISREL models is estimated by the validity of the entire model (nomological validity), and also the extent of separation between constructs (discriminant validity), and the homogeneity of constructs (convergent validity). Nomological validity is important since the structural model should be viewed as an entity, in which causal effects reinforce and counteract each other in a complex pattern. For example, if the relation from a to b to c is investigated, then a affects b, and b affects c, but a also affects c, indirectly, via b. LISREL has a way of estimating direct, indirect and total effects in complex causal patterns. The overall fit of the LISREL models is assessed by Chi-2 and degree of freedom measures and a probability estimate (p-value) (Jöreskog and Sörbom 1993:121). The Chi-2 and degree of freedom together measure the distance between data and model, and the computed p-value is a test statistical significance. Together these variables measure nomological validity. Discriminant and convergent validity are judged by studying the t-values and R2-values of each relation in the model. The R2-value is a measure of the strength of a linear relationship estimate (Jöreskog and Sörbom 1993:121). As a test of significance, the t-values are studied (Jöreskog and Sörbom 1993:108).

**Construct Validity**

Relationship heterogeneity is operationalized in three indicators. The first concerns the variation of the customers’ adaptations, by type of customer relation. The second concerns the variation of the bank’s adaptations, by type of customer relation. The final indicator concerns the variation of mutual adaptation between the bank and customer, by type of customer relation. All key statistical values are good for this construct to be convergently valid. Factor loadings and R2-values are high, and t-values are well above 1.96.
Table 1. The Constructs and their Indicators.

<table>
<thead>
<tr>
<th>Construct /Indicator</th>
<th>Code in Figure 2</th>
<th>Factor Loading</th>
<th>t-value</th>
<th>R²-value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Relationship Heterogeneity</strong></td>
<td></td>
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<tr>
<td>Is there little or much variation by type of customer relation in the customer’s contribution to establish and develop bank-customer relations?</td>
<td>C-HET</td>
<td>0.64</td>
<td>6.28</td>
<td>0.41</td>
</tr>
<tr>
<td>Is there little or much variation by type of customer relation in the bank’s contribution to establish and develop bank-customer relations?</td>
<td>S-HET</td>
<td>0.64</td>
<td>6.32</td>
<td>0.41</td>
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<tr>
<td>Is there little or much variation by type of customer relation in the mutual adaptation between customer and bank? Scale: 7-steps from little variation to much variation.</td>
<td>M-HET</td>
<td>0.53</td>
<td>5.23</td>
<td>0.28</td>
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<tr>
<td><strong>Information Diversity</strong></td>
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<td></td>
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<td></td>
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<tr>
<td>Is the difference in kind (typ) of information small or large? Scale 7-steps from small to large.</td>
<td>KIND</td>
<td>0.97</td>
<td>6.91</td>
<td>0.94</td>
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<tr>
<td>Do you use information from few or many sources? Scale 7-steps from few to many.</td>
<td>NUMBER</td>
<td>0.62</td>
<td>6.72</td>
<td>0.38</td>
</tr>
<tr>
<td><strong>Intended Relationship Strategy</strong></td>
<td></td>
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<tr>
<td>What growth strategy is your bank’s, according to you? Scale: 7 steps from Acquire new customers to Develop existing customer base.</td>
<td>INTEND</td>
<td>1.00</td>
<td>1.00</td>
<td></td>
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<tr>
<td><strong>Relationship development</strong></td>
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<tr>
<td>Is it easy or difficult for the customer to understand and use your services?</td>
<td>USE</td>
<td>0.36</td>
<td>2.97</td>
<td>0.13</td>
</tr>
<tr>
<td>Is it easy or difficult to get new customers to the bank? Scale: 7 steps from Easy to Difficult.</td>
<td>ATTRACT</td>
<td>0.62</td>
<td>3.67</td>
<td>0.38</td>
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<tr>
<td><strong>Locus of Realized Strategy</strong></td>
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<tr>
<td>Where is the bank’s strategy carried out, according to your opinion? Scale: 7 steps from Centrally to Locally.</td>
<td>LOCUS</td>
<td>1.00</td>
<td>1.00</td>
<td></td>
</tr>
</tbody>
</table>
Information diversity is operationalized in two indicators, of which the first concerns the difference in the type of information. The second indicator comprises the number of information sources used in work. Although both indicators are valid for the construct, it is evident that the difference in kind of information is almost identical with the information diversity construct itself. This is shown by a factor loading of 0.97.

The intended relationship strategy is a single item construct that concern the growth strategy of the bank. The scale ranges between acquiring new customers and developing the existing customer base.

Relationship development has two indicators. The first measures the customer’s difficulty to understand and use services, and the second the difficulty in attracting new customers to the bank. Both indicators are valid in relation to the construct, even though the customer’s difficulty in understanding and use of services has a low R2-value (0.13). The R2-value is not unacceptably low, and since other key statistics are good, and because of conceptual reasons, we choose to retain this indicator with the construct.

The locus of realized strategy is a single item construct that ranges on a scale from central to local implementation of the bank’s strategy.

**Results**

The empirical results of the hypothesized structural model is depicted in Figure 2. The model is nomologically valid since the Chi-square is 33.76, with 24 degrees of freedom, at a probability of 0.09. Almost all key statistical values are good. The only questionable one is an R2-value of 0.15 between intended relationship strategy and relationship development. The relationship has a strong factor correlation (0.50) and significant t-value (3.10). The low R2-value thus indicate a weak linearity in relations, rather than weak relations altogether. On the grounds of the strong relationship, and the fact that an R2-value of 0.15 is not alarmingly low, we accept the relationship as a valid part in the model.
The results in Figure 2 support the hypothesized causal relations in Figure 1. The more heterogeneous the relationships, the more information diversity is perceived (0.51 in Figure 2). Increased information diversity makes it more difficult to develop relationships (0.48). This causal chain confirms that heterogeneity of firm - customer relations is a key factor for information diversity, and hence management in firms. The results also show that the internal capacity to handle work flows is instrumental in developing customer relations.
The firm’s intended relationship strategy has a strong effect on relationship development (0.50). This result does not confirm hypothesis 3. Instead, the more a firm’s strategy focuses on acquiring new customers, rather than development of existing customer relations, the easier the firm can develop customer relationships. This result shows that acquiring new customers is superior to the development of existing customer relations as a growth strategy in banking.

Lastly, the more difficult it is for the bank to develop customer relationships, the more centrally is the bank’s strategy carried out (-0.39). This result is surprising, and does not confirm hypothesis 4. We expected that difficulty of relationship development should call for a more local strategy, since the key relationship activities normally is handled locally.

Conclusions and Implications
This study has shown that relationship development is simultaneously contingent on customer relationship heterogeneity and customer relationship strategies. This result suggests that relationship development is not solely a matter of customer relationship satisfaction, rather, it is a combination of relationship heterogeneity, management in the firm and relationship strategies in the firm.

An important result from this study is that relationship heterogeneity has such strong effects on management of customer relationships. The implications of this is that bank managers should develop organizations so that relationship adaptation can be achieved. This is not simply a matter of segmenting customers, but also signals the need to manage the relationship exchange. We have argued previously that relationships are constituted by value creating transformations in which the customer may contribute in different ways. Relationship development is to improve these processes by capitalizing on an increasing customer involvement. It is evident that bank managers are clearly aware of the impact of heterogeneous customer relationships on their work.

It is interesting to find that acquiring new customers is the easiest way to develop customer relations. As mentioned earlier, banking is known for its strong customer
ties. Therefore, we hypothesized that the best way to develop customer relations would be to enhance the existing ones. There are many possible explanations for this finding. For instance, the bank’s investigated may not be good at managing heterogeneous relationships. In such a case it will be very difficult for a branch manager to develop existing customer relations, because the organization does not support such a behaviour. Another explanation may be that relationship development actually may be more difficult in existing than new relations. Customer contributions in existing relationships have already been defined and routinized whereas new relationships have yet to be moulded.

Another interesting result is that more difficult relationship development is handled at a more central, rather than local level. This is contrary to the view that the point of relationship exchange is where problems are best solved. The contextual knowledge that a bank branch manager develops on relationships with local customers is a great asset. When customer relationships are lifted out of their situational context, to a more central level, the understanding of the customer contributions should be reduced, rather than increased. This may impede further relationship development. We may speculate that the bank organization wants to gain control of difficult relationship development, by using a pool of central specialists. Nevertheless, we maintain that banks should establish relationships with customers in their local context, rather than bringing the customers to headquarters.
References


