

# **An Extensive Review on the Impact of Customer Retention Practices towards the Performance of SMEs**

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## **Abstract**

Contribution of small and medium –sized enterprises (SMEs) towards the economic growth is vital. This is factual in Malaysian context whereby about 90 percent of players in the key economic sectors consist of SMEs. Nevertheless, these SMEs are encountering numerous problems, which inhibit their progress and subsequently lessen their survival rate in the competitive industry. Customer retention practice is considered as one of the significant weapons for these SMEs to sustain in the said competition and, hence improve their performance. Due to the significance of customer retention practice and the role of SMEs towards the nation's economy, this study intends to explore possible factors that influence service-oriented SMEs' customer retention practices and its subsequent impact on their firm's performance. This study has done extensive reviews covering 10 years of literatures to recognize the related dimensions, prior to constructing the research model of the study. Accordingly, some recommendations for future researches are also provided.

**Key words:** customer retention, firm performance, non-financial performance, service-oriented firms

## **1.0 Introduction**

Service sector is one of the important segments for the global economic growth. Its global Gross Domestic Product (GDP) has been rapidly expanding and has accounted for about two thirds of the world's trade (Lo et al. 2007). At present, knowledge cum labor-intensive service industries such as information and communication technology, financial, healthcare, entertainment, biotechnology and education are the world's crucial fortune initiating industries (MITI, 2011). As such, the Malaysian economy has involved in a structural transformation from the manufacturing to services sector. The services sector is ranked as the largest contributor to the nation's real GDP amounting to 58.6% in 2011 (Lo et al. 2007). Accordingly, the sector has received the largest allocation of investment amounting to 67.5% (RM59 billion) from the total investments of RM87.3 billion in the first half of 2012. On the other hand, the manufacturing sector only secured 29.5% (RM25.8 billion) of investments (Department of Statistics, 2012).

The Malaysian service sector consists of more SMEs amounting to 98.2%, followed by 95.4% in the manufacturing and 87.1% in the construction sector. Their huge population in the Malaysian key economic sector is also represented by their significant contribution to the nation's GDP. In 2011, the economic growth recorded by SMEs was 6.8% but the overall economic growth of the nation was 5.1% (Department of Statistics Malaysia, 2012). Thus, the SMEs are gaining attention because they are considered as the backbone of the Malaysian economy (Mahalingam, 2012).

Nevertheless, it is certain that the Malaysian SMEs are also facing numerous barriers and challenges, which inhibits them from expanding their businesses (Bahador and Haider, 2012). Lack of skillful personnel, poor market access, insufficient finance, competition from foreign SMEs and technological limitations has been ear marked as the deterrents of SMEs (Haron et al. 2010). Therefore, SMEs require monetary support to reduce the impact these barriers might pose and subsequently improve their performance (Desi, 2011). Besides monetary support, customer retention is also found to improve SMEs' performance. The improvement in firm performance is implied particularly in their finances where by having greater number of retained customers, the firms could reduce cost otherwise spent in acquiring new customers (Ghavami and Olyaei, 2006; Steven et al. 2012). As such, it is vital for SMEs to retain their existing customers, as minor changes in customer retention rate will multiply firm's profitability and hence their performance (Hansemark and Albinsson, 2004; Van den Poel and Larivie're, 2005). Despite the prospects of retention practice in improving firm's performance, according to Nitzan and Libai (2011), there is lack of related literatures as the current focus is more on the acquisition of new customers instead of retaining existing customers. Thus, this study is expected to contribute towards the body of knowledge by exploring factors that influence SMEs' performance mediated by customer retention practices.

## **2.0 Influences of Customer Retention**

### **2.1 Customer Retention**

An extensive review on past literatures from 2003 till present has been done on customer retention practices among service-oriented firms (refer to Table 1). Briefly, influencing factors of customer retention practices are customer satisfaction, switching

barriers, price perception, customer loyalty, perceived service quality and customer service. In addition, the measurements of customer retention practices are repeat purchases and positive word of mouth. Besides, non-financial metrics were identified as the most appropriate measures for evaluating the firm's performance resultant of customer retention practice.

**Table 1: Summary on Past Literatures from 2003 until Present**

Variables/ Author	Influencers														Customer Retention					Firm Performance																
	Satisfaction	Social	Switching cost	Trust	Commitment	consumption emotion	pricing	feature preference	shopping habit	loyalty program/customer	top management support	employee	relationship marketing	perceive Service Quality	membership	IT Competency	value	quality	image	firm policy	customer service	overall	Word Of Mouth	Repeat Purchase	Price Insensitivity	Non-Complaining Behavior	Usage	Tenure	Personal	Overall	Non-Financial Performance	Financial Performance				
Rana weera & Prabu 2003	√		√	√																		√														
Gustafsson 2005	√				√																	√							√							
Wong 2005	√		√																			√														
Han et al. 2009	√		√		√																			√												
Seo et al. 2008	√		√																			√														
Kim et al. 2004	√		√																			√														
Polo et al.						√	√															√														





commitment towards firm and its offerings for a specific period of time through their repeat purchases and tendency in spreading positive word of mouth among their social circle (Kumar, et al. 2007; Han et al. 2009; Jeng and Bailey, 2012).

Repeat purchase intention is regarded as the customer's decision about re-purchasing a chosen service from the same service provider, taking into consideration the customer's present condition and other possible occurrences (Yap and Kew, 2007). Customer's emotional attachment such as loyalty and commitment towards a service provider frequently influences repeat purchase intentions (Han et al. 2009). Studies found that satisfied customers with positive experience will repurchase which will in turn improve firm's performance (Chiu, 2010). It implies that customers' repeat purchase intention is indirectly influenced by services provided to customers, which will subsequently create favorable experiences for them (Park et al. 2010).

Word-of-mouth (hereafter WOM) is described as an endorsement and references from satisfied customers about a firm and its offerings, which are considered as an effective tool in business (Mulindwa 2005). WOM usually includes remarkable comments about a product's performance, service quality and firm's trustworthiness from one customer to another customer. It is believed that exceeding customer's expectation would influence the customers to engage in spreading news about the firm (Küçükosmanoğlu & Şensoy 2010). It shall be a competitive advantage for a firm as the spread of positive news is exclusive for a specific firm and does not belong to others (Wangenheim and Bayón, 2007). Such advantage enables the customers to easily distinguish their preferred firm from other firms in the market. Besides, such news would increase potential customers' confidence level towards the firm. In addition, the propagating customers are also seen as important reference groups for potential customers and, at times, they may still propagate about the firm though they did not purchase from the firm (Mulindwa, 2005; Sharmeela-Banu, et al. 2012).

## **2.2 Influencing Factors of Customer Retention.**

As indicated in Table 1, customer satisfaction is the key influencing factor of customer retention practice. Customer satisfaction is defined as a sense of comfort and attachment that results from achieving customer's expectation and anticipation (Mulindwa 2005). Customer satisfaction can be also described as a pleasant experience that creates an emotional bond between a customer and the firm (Seiders et al. 2005; Yee et al. 2008). However, level of satisfaction differs across individual customers despite their experience with similar service providers (Mulindwa, 2005). Customers with greater satisfaction level would frequently buy in larger volume besides acquiring new products from the same provider (Burke Incorporated, 2004; Mulindwa, 2005). They are also known for spreading news about their favorable experiences among their social circles. In addition, reasonable price, efficient customer service and good handling of customers' dissatisfaction are essential ways to create and maintain a satisfied customer (Burke Incorporated, 2004; Yee et al. 2010). Customer's perception towards firm's performance is also seen as a catalyst in satisfying customers as it is believed that customers who are satisfied and contented with the firm's performance would be loyalists of the firm (Gustafsson 2005; Seo et al. 2008).

Customer loyalty denotes as the sense of bonding that a customer has towards a firm and its offerings which enhances their stay with the firm (Rachel W.Y. et al. 2010). Attitude of loyal customers certainly favor the firm as the loyal customers will stay longer and increase their purchases besides being customer evangelists (Oyeniyi & Joachim, 2008). Loyal customers can be grouped into four segments namely secured, satisfied, vulnerable and dissatisfied (Burke Incorporated, 2004). Secured customers are very satisfied patrons who will definitely recommend and continue to purchase from the firm. On the other hand, satisfied customers are patrons who will probably recommend and continue purchasing from the provider due to their satisfaction with the firm. Meanwhile, dissatisfied customers are believed to discontinue their purchases with firms besides not recommending firm to others due to their dissatisfaction level. However, the attitude of vulnerable customers towards the firm is susceptible due to their marginal satisfaction with the firm. Firm's loyalty program that rewards customers based on their cumulative purchases is an essential way to enhance customer loyalty besides being an indirect effort to enhance customer retention practice (Lewis, 2004). It inherently encourages repeat buying by providing incentives for customers to accelerate their frequency of buying sometimes even in a larger volume (Lewis, 2004). On the other hand, according to Trassoras et al. (2009), value offered by firms to customers, customer's confidence with firm and firm's efforts to stay closer with customers are vital to enhance customer's loyalty. Lehtinen (2002) also emphasized the notion of interaction in suggesting that "customer service" is synonymous with "interactive quality", which relates to the interaction between customer and service personnel.

Satiating customer service has a significant impact on firm's retention tactics (Omotayo and Joachim, 2008). Customer service is described as the provision of add-on services for firm's merchandises despite the nature of its offerings (Roberts et al. 2003; Qin et al. 2009). Besides, Qin et al. (2009) had highlighted the importance of two-way communication between customer and firm's personnel in augmenting the quality of add-on services provided. Steven et al. (2012) had claimed that the improvement in customer service would subsequently enhance customer's satisfaction. The execution of services would determine the customer's perception towards firm (Gan et al. 2006). Handling customers through a good service by understanding their requirements, preferences and needs would certainly help firms to preserve their customers. This is in line with Bassey (2011)'s claim on the importance of good customer service in fostering customer' loyalty which will in turn augment firm's retention practice.

According to Yap and Kew (2007), there is a significant relationship between service quality and customer's intention for repeat purchases with the same firm. Perceived service quality is defined as a variation between customer's anticipation and firm's actual performance where customers tend to revisit the firm that provides service, which exceeds their expectations (Kim et al. 2004). It is also well noted that awareness towards firm's service quality is greater among retained customers mainly due to their familiarity and experience with the firm and its offerings (Sharmeela-Banu et al. 2012). In addition, characteristics of products, provision of additional services, good customer care, reasonable price and user friendly procedures are believed to greatly influence customers' perception towards the quality of firm's service (Reinartz and Kumar, 2003; Kim et al. 2004).

Customer's perception on price always acts as a key driver for customer's behavior on their decision of patronizing the firm (Bolton, et al. 2004). Practitioners and researchers have

recognized that pricing tactics employed in acquiring customers are also influencing customer's retention and lifetime value with the firm (Polo et al. 2011). It is discovered that customers' price awareness such as detection of price fairness among service providers tends to be a central determinant of post-purchase gratification and hence, their repurchase intention. On the other hand, customer's switching intention; tendency to endorse and likelihood of continuously dealing with the firm are some of the possible implications from customer's perception on firm's pricing strategy (Jiang and Rosenbloom, 2005).

Switching cost is simply defined as implications that customers encounter in switching to a new firm (Ranaweera and Prabu, 2003). Exit fees, search costs, learning costs, cognitive efforts are some of the switching costs which a customer needs to bear when he switches to a new firm (Ranaweera and Prabu, 2003; Kim et al. 2007). Hence, customers' preference to be committed and continue staying with the firm in order to avoid numerous switching costs is found to be one of the key drivers for the firm's retention practice (Seo et al. 2008). Despite their dissatisfaction with the firm, some customers tend to stay longer with the firm mainly due to increases in the switching costs (Kim et al. 2007). In line with this, Han et al. (2009) had discovered that switching costs would positively influence the number of retained customers that a firm holds. According to Seo et al. 2008, duration of relationship between the firm and customers, complexity of services offered and firm's good communication skills are vital to increase the switching cost borne by customers which will then improve the current firm's retention practice.

### **2.3 Firm performance**

Firm performance has been identified as the central determinant of firms' competency in retaining customers (Yee et al. 2010). Firm's performance measurement can be divided into two components namely financial (FP) (Kaplan and Norton, 2001) and non-financial performance (NFP), which respectively evaluates firms' monetary and non-monetary dimensions (Kaplan and Norton, 2001; Avci et al. 2010). Financial performance reflects the firm's financial situation which can be evaluated using indicators such as profit margin, return on assets (ROA), returns on sales (ROS), return on investment (ROI) and others (Huang et al. 2004; Yee et al. 2010).

However, in the service sector, firm's performance is evaluated by referring to NFP metrics and this is due to the characteristics of service, which are intangible, labor-intensive, and customer centric (Chatterji and Levine, 2005; Walsh et al., 2008). NFP measures inherently focuses on the long-term achievement of firms by concentrating on customer gratification, internal business process, productivity, invention, and employee fulfillment (Laitinen, 2002; Avci et al. 2010). Furthermore, dimensions such as quality of service, resource consumption, and invention are also influencing firm's non-financial performance (Aramyan, et al. 2007; Zigan and Zeglat, 2010). Measures of non-financial performance can be grouped into three (Zigan and Zeglat, 2010) namely human capital (knowledge, expertise, level of employee's education and the approachability of staff), structural capital (organizational arrangement and infrastructure maintenance) and relational capital (relationship with internal and external shareholders). According to Zigan and Zeglat (2010), customer satisfaction and loyalty were also found to be the core components of firms' non-financial performance.



### 3.0 Construction of Research Model

A research model is built based on the extensive review of past studies (refer to Figure 1). This model exhibits that firm's customer retention practice relies on the six influencing factors namely customer satisfaction, switching cost, perception on pricing, customer loyalty, perceived service quality and customer service. These influencing factors are predicted to significantly affect the firm's performance with the mediation effect from firm's retention practice. Table 2 depicts the summary of these influencing factors in terms of the proposed key attributes accompanied by the original sources.

**Table 2: Attributes of Influencing Factors**

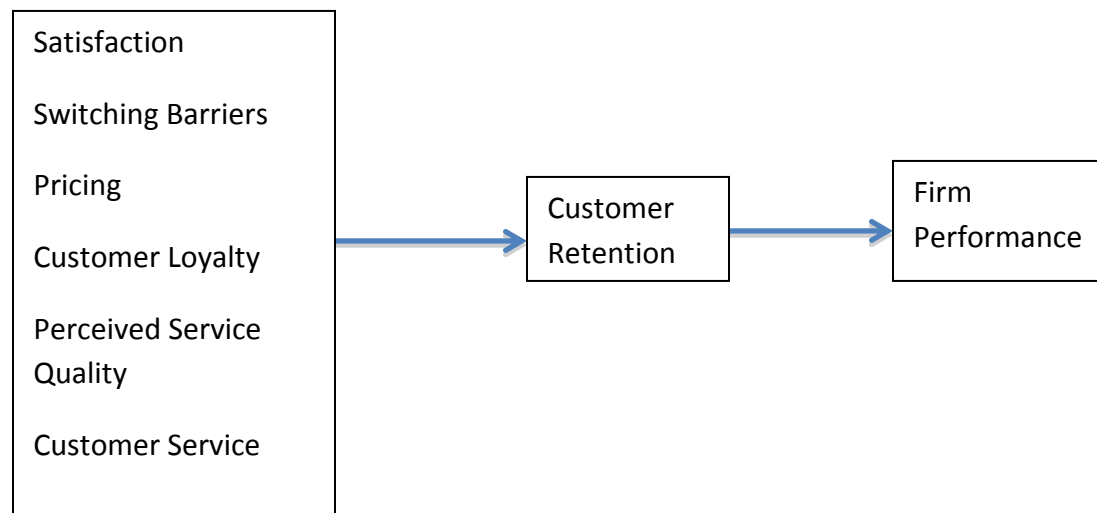
Influencing Factors	Attributes	Author & Year
Customer satisfaction	Sense of comfort, Attachment, Pleasant experience.	Mulindwa 2005; Seiders et al. 2005; Yee et al. 2008
Customer Loyalty	Sense of bonding, Stay longer, Increase purchase.	Rachel W.Y. et al. 2010; Oyeniya & Joachim, 2008
Customer Service	Add-on services, Understanding customer	Roberts et al. 2003; Qin et al. 2009; Basse, 2011)
Perceived Service Quality	Perception on the actual performance, Awareness.	Kim et al. 2004; Sharmeela-Banu et al. 2012
Price Perception	Perception on the pricing technique, Price fairness.	Jiang and Rosenbloom, 2005; Polo et al. 2011
Switching Cost	Exit fees, Search cost, Learning cost.	Ranaweera and Prabu, 2003; Kim et al. 2007

This study attributes customer retention as the recurrence of purchases made by a customer and his/her tendency in disseminating positive information regarding the firm and its offerings to others (Kumar, et al. 2007; Han et al. 2009; Jeng and Bailey, 2012). Repeat buyer is

considered as having favorable experience, loyalty and commitment to the same firm for a prolonged duration (Han et al. 2009; Park et al. 2010). On the other hand, spreading positive word of mouth is viewed as customers' likelihood in giving remarkable and exclusive comments about a specific firm besides providing testimonial and references about the firm to their social circle (Küçükosmanoğlu & Şensoy 2010; Wangenheim and Bayón, 2007).

This study has been devoted to exclusively examining the measures of non-financial performance (instead of financial performance) resulted from retention practices. This is in line with the study's proposed target population i.e. service-oriented SMEs. According to Chatterji and Levine, 2005, evaluation on the non-financial performance is more appropriate for service firms due to their intangible nature of operation. Accordingly, this study has adapted the typology of Zigan and Zeglal (2010) on measuring the firm's non-financial performance. Improvement in the relationship among stakeholders, employee's satisfaction and customer's gratification are the key measures of NFP in this study.

**Figure 1: Proposed Research Model**



**4.0 Research Opportunities**

The proposed research model can be used to enlighten the service-oriented firms regarding dimensions that should be considered in retaining their existing customers. These firms can employ apposite business strategies in line with these dimensions in order to leverage the potential growth of their business operations, in general and performance, in particular.

The said model can be also used to examine customer retention practices and its influences alongside its impact on firm's performance within other economic sectors. On the other hand, fellow researchers from other countries with similar profiles as Malaysia can also employ it. In addition, cross-comparison study across several economic sectors based on this framework is greatly deemed to be pertinent. Respondents should be from service firms operating within several economic sectors e.g. insurance, education, wellness center, retailing and transportation in order to obtain varied responses pertaining to customer retention practices.

In addition, studies adopting this model are recommended to employ mixed-mode research technique. It will be more appropriate to begin the research by exploring customer retention practices at selected firms via depth interviews. As such, underlying perception of firms towards customer retention practices could be easily uncovered. Such approach would also discover other possible dimensions that are not covered within the proposed model. Based on the additional dimensions discovered from this exploratory stage, researchers shall proceed with a descriptive approach to further understand the issues concerned in detail.

Furthermore, future researches shall examine the impact of customer retention towards both financial and non-financial performance in order to obtain the overall view of their firm's performance. Besides, it is also highly recommended to conduct studies involving both small-medium sized and large-scaled service-oriented firms within a specific economic sector in order to understand the impact of firm size towards customer retention practices.

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