

The relationship
between customer
satisfaction and
organisational
profitability f...



It is well known fact that the goal of any organisation is to meet the needs and the requirements of its stakeholders. Satisfying this need will not only ensure the survival of the organisation but also allow it to flourish. Among the several stakeholders, customers are presumed to be one of the most important stakeholders as no organisation can survive and succeed without them. Accordingly, marketers emphasize on research in the area of consumer behaviour and particularly behavioural intention. Knowledge of consumer behaviour will go a long way in ensuring effective marketing policies towards the interest of customers which will eventually facilitates positive customer attitude towards the organisations. More especially, since customer behavioural intention is a strong indication of his actual behaviour.

2. As a result of financial sector liberalization in Sri Lanka in the 1979, the banking sector experienced a boom. Low entry requirements such as capital of Rs 10 million by the regulatory authority and the high premiums that could be earned through foreign exchange business led to the quick entry by new players into the lucrative banking industry. In Sri Lanka between the period of 1979 to 2011 the number of commercial banks rose from 11 to 32 (Central Bank of Sri Lanka- CBSL)[6]

3. The banking industry is highly competitive, with banks not only competing among each other; but also with non-banks and other financial institutions (Hull, 2002)[7].

Most bank product developments are easy to duplicate and when banks provide nearly identical services, they can only distinguish themselves on the basis of price and quality.

Therefore, customer retention is potentially an effective tool that banks can use to gain a strategic advantage and survive in today's ever-increasing banking competitive environment. The majority of Sri Lankan commercial banks are owned by Sri Lanka Banking companies and the States and they are not much diversified in terms of the products and services they offer. Therefore almost all banks are offered almost identical products to their customers. Mendzela, was of the view that it is an indication of bank reaching the maturity phase of the product lifecycle and has become commoditized. One strategic focus that banks can implement to remain competitive would be to retain as many customers as possible[8].

4. As discussed earlier, financial sector has shown unprecedented growth after deregulation in Sri Lanka. The Sri Lankan financial markets have experienced drastic changes after financial liberalization during 1979 and that provokes competition among financial institutions especially in banking sector. This competition leads to the introduction of customer oriented products in the market to meet the expectations of customers. Satisfaction is a multidimensional construct which has been conceptualized as a prerequisite for building relationships and is generally described as the full meeting of one's expectations (Oliver, 1980).

5. The most significant trend, relevant to all industries, which characterizes in 21st century, is severe competition between companies. In current operational environment, defined by constant change and uncertainty, organisations are forced to seek new ways to achieve the competitive advantage. This is particularly true for financial services industry where deregulation has brought a considerable choice for customers in satisfying

<https://assignbuster.com/the-relationship-between-customer-satisfaction-and-organisational-profitability-finance-essay/>

their needs. Banks have high financial leverage capital structure, where customer's bank deposits are considered as a bank debt. Therefore, customer turnover may result not just in diminishing profit margin but also in financial services provider existence. Apart from that, loyalty and satisfaction resulting in switching to another financial services provider may be used as a competitive advantage for acquisition new market share enticing consumers of the competitor.

6. Customer satisfaction has become interesting tool for commercial banks with the competition and it has become a practice to keep customer satisfied by banks, as satisfied customers will enhance customer loyalty towards their banks which will ultimately improve banks performance and profitability. The importance of customer satisfaction cannot be dismissed because happy customers are like free advertising. Many of us have heard of the current trend for businesses to become highly customer-centric, that is to put the customer at the centre of our business in terms of our strategies, actions and processes. For most of us, old truths still hold well, such as it is easier and more profitable to sell to existing customers than to find new ones. In practice, organizations are increasingly setting themselves strategies to measure and ensure customer retention, and charging their staff to be more customer-focused and service-oriented.

BACK GROUND OF THE STUDY

7. According to Central Bank of Sri Lanka the overall performance of Licensed Commercial Banks (LCBs) remained healthy due to improved profitability and the strengthening of their capital position. The activities of

LCBs expanded at a moderate pace in the first half of 2010. Total assets of the LCBs expanded by Rs. 139 billion or 5.5 per cent due to a growth in lending activities coupled with an increase in investment in government securities and the equities market. Meanwhile, deposits increased by four per cent or Rs. 74 billion as against 9 per cent in the previous year due to the lower interest rates that prevailed in the market during the period[9].

8. As mentioned earlier, banking sector has shown unprecedented growth after deregulation in Sri Lanka. Sri Lankan financial markets experienced drastic changes after liberalization during early 1979 that provokes tough competition among financial institutions especially in banking sector. This competition leads to the introduction of customer oriented products in the market to meet the expectations of customers.

9. According to the Fitch Ratings (2012)[10], Sri Lankan banking sector is concentrated and dominated by public-sector banks that accounted for about half of sector assets at end of 2010. The six large banks identified as Systemically Important Banks (SIB)[11] accounted for 64 per cent of sector assets at end of 2010. They are Bank of Ceylon, Commercial Bank, Hatton National Bank, People's Bank, Sampath Bank and Seylan Bank. Fitch ratings has further pointed out that the Sri Lankan banking system experienced a strong upturn in profitability in 2010, with ROA increasing to 1.8 per cent, significantly above the 1.1 per cent average in 2000-2009, largely due to a reduction in credit costs. However, profitability decreased in 2011, with the sector posting an ROA of 1.6 per cent, largely due to the contraction in net interest margins (NIMs) with intensifying competition.

10. Almazari(2011)[12]was of the view that financial performance of a bank is its return on investment, return on assets, value additions and net assets value of a bank evaluates how the bank has used it assets to generate revenue. Further Almazari has pointed out that total assets of a bank also help to evaluate how well a bank is using its resources to make a profit. Total assets of commercial banks in Sri Lanka for the periods 2007-2011 is given below. The modern business world has expanded and competition has been created among businesses based on the profit. Financial services and assistance provided by the banking sector in Sri Lanka is at the top. These banks provide facilities not only for ordinary people but also for businessmen. Customer satisfaction plays a vital role in any successful business organization in today's business strategy.

To go forward through this business banks have to compete with each other to achieve their goals, while fulfilling the basic requirements to satisfy their customers. At the very beginning, the main purpose of establishing banks were to give benefit for selected rich people, but at present, all levels of people are benefited and obtained the services from banks which have being expanded all over the country.

The current banking industry in all over the world is going through turbulent times. In Sri Lanka with the lowering of entry barriers and blurring product lines of banks and non-banks since the financial sector reforms, banks are functioning increasingly under competitive pressures. This situation has created banks to maintain loyal customer base for individual banks. In order to maintain a loyal customer base and improve their market and profit

positions, almost all the banks are directing their strategies towards
<https://assignbuster.com/the-relationship-between-customer-satisfaction-and-organisational-profitability-finance-essay/>

increasing customer satisfaction and loyalty through improved service quality. In the present competitive Sri Lankan banking context, characterized by rapid change and increasingly sophisticated customers, it has become very important that banks in Sri Lanka as well to determine the service quality factors which are pertinent to the customers' selection process. Therefore the current problem for the banking industry in Sri Lanka is to determine the dimensionality of customer perception of service quality. This is because if service quality dimensions can be identified, bank should be able to improve the delivery of customer perception of quality during the service process and have greater control over the overall outcome. In relation to customer loyalty all banks in Sri Lanka has adopted various programmes to keep customers satisfied but according to discussion carried out earlier, public domestic banks are performing better than the government owned banks in the country.

12. Basically, Banks Profitability is measured with two major ratios that of Return on Average Assets and Return on Average Equity. Return on Average Assets and Return on Average Equity of five large commercial banks are for the period of five years from 2007 given below.

Table 1: 1 Return on Average Assets

Year

BOC

People's Bank

Commercial Bank

HNB

Seylan

ROAA

ROAA

ROAA

ROAA

ROAA

Per Cent

Per Cent

Per Cent

Per Cent

Per Cent

2007

1. 11

1. 4

1. 67

0. 87

0. 67

2008

1. 13

1. 5

1. 55

1. 04

0. 1

2009

0. 82

1. 4

1. 43

1. 42

0. 38

2010

1. 6

1. 7

1. 6

1. 04

0. 87

2011

2. 01

2. 5

1. 98

1. 78

0. 64

Table 1: 2 Returns on Average Equity

Year

BOC

People's Bank

Commercial Bank

HNB

Seylan

ROAE

ROAE

ROAE

ROAE

ROAE

Per Cent

Per Cent

Per Cent

Per Cent

Per Cent

2007

14. 59

20. 5

20. 63

35. 9

13. 84

2008

16. 13

18. 8

17. 13

33. 6

2. 22

2009

12. 85

19. 7

15. 83

28. 9

6. 2

2010

24. 01

26. 9

17. 87

28. 5

10. 88

2011

33. 74

42. 9

20. 76

24. 1

6. 78

(Source: Annual Reports year 2007 to 2011)

13. When ROAA and ROAE averaged for the last five years ranks of the banks on both ratios are given below.

ROAA

ROAE

Commercial Bank

Hatton National Bank

People's Bank

People's Bank

Bank of Ceylon

Bank of Ceylon

Hatton National Bank

Commercial Bank

Seylan Bank

Seylan Bank

14. From the above information it could be seen that two state owned banks has ranked number 2 and 3 in both ROAA and ROAE while a private bank has been the number 1 in ROAA and ROAE. This gives a mixed signal about the profitability of commercial banks in Sri Lanka.

RESEARCH PROBLEM

15. According to the indication given in table 1 and further analysis, in terms of major measures in bank profitability, public domestic banks were headed in both measurement and two states banks were maintained second position. Therefore, the research problem for this study is as to why public domestic banks were headed in profitability and how two states banks were maintained second positions and whether it is customer satisfaction of the respective banks.

OBJECTIVES OF THE STUDY

16. Following objectives should be achieved at the end of this research.

a. To discover the reasons that is attributed to the higher profits in public domestic commercial banks than the state owned commercial banks in Sri Lanka and,

<https://assignbuster.com/the-relationship-between-customer-satisfaction-and-organisational-profitability-finance-essay/>

b. To ascertain whether it is due to customer satisfaction of the private commercial banks or any other reason.

SIGNIFICANCE OF THE STUDY

17. Discovering the performance between public domestic commercial banks and the state commercial banks will be more significant to the banking industry as well as to the government to introduce required mechanism to overcome the present problem if any prevailing in states banks in relation to the performances. Almost all financial institutions try to attract customers to them in the business environment . In that case commercial banks try to fulfill their customer's needs in most efficient manner. Financial institutions should have the ability to identify the customer's needs to give their service in efficient manner. Therefore, they have to provide good products, in good time to achieve profitability in the competitive environment.

18. The end results of this research that of customer satisfaction and commercial banks profitability in state owned and public banking companies will be of great contribution to the field in the academics and for the practitioners. This study will also assess and evaluate the level of satisfaction of the customers in the banking business in Sri Lanka which will contribute to the industry as well as to the policy makers. It will also reveal areas and factors that need consideration for improvement. Further at the end of the research, it is expected to cerate a good knowledge about what customer needs can be gained. With an understanding about the change of customer satisfaction which is depend on nature of customer, the bank can provides suitable services to their own customers. If the customer gets the service

continually, the institution may also introduce innovations to their own customers.

SCOPE AND LIMITATION OF THE STUDY

19. Scope of this study is to analyze all data that are available to find out as to why state commercial banks are earning less profit than the public domestic commercial banks including service quality and customer satisfaction and non-performing assets if necessary arises. Accordingly, the study will be using both primary and secondary data. In studying service quality and customer satisfaction data have to be collected through a questionnaire but in analysing NPA bank's actual information which are recorded in financial statements have to consider. There is no limitation in acquiring secondary data as all information are available in the annual reports of the banks. For the purpose of collecting data there is a limitation of selection of banks. Also, when considering the profit of the banks, only internal factors that are related to the banks leaving external factors as they are beyond the scope of the study.