CUSTOMER SATISFACTION AND CUSTOMER LOYALTY IN EUROPEAN RETAILING

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Abstract

Customer satisfaction and customer loyalty is becoming an increasingly important factor in modern retailing - a market characterized by slow growth and intense competition. Big non-European chains such as Walmart are already present in some countries and consider to buy some of the retail chains in other countries e.g. the Scandinavian countries. This development will demand even more focus on customer satisfaction and customer loyalty in order to stay in business and may also demand that existing actors on the market place form new coalitions. Promising new partners may be identified partly based upon measures identifying how potential partners are perceived by the customers. Based on results from the European Customer Satisfaction study a comparative analysis of customer satisfaction in Europe is conducted. Some specific Danish results are shown and the relationship between customer loyalty, supermarket type and ownership structure is studied.

1. Introduction

European food retailing structure is rapidly changing. Concentration is increasing both through ownership and store size and companies are responding to slow growth in home markets by expanding into other markets. Store chains are increasingly being branded in order to increase differentiation between chains subsequently increasing store loyalty. Private labels have obtained a more dominant role within the last years. They may be seen as a way to increase differentiation but of course they are also the retailers opportunity to avoid the costs of marketing, incurred by the producers brand, yielding higher gross margins.

Operating in such a market with slow growth and intense competition demands focus on customer satisfaction and customer loyalty to obtain positive net operating profits. The purpose of this article is to empirically analyse the question of customer satisfaction and loyalty in retailing, to investigate possible effects of ownership and type in Danish retailing, and to study the relationship between customer loyalty and profit in Danish retailing. The empirical analysis is based on data obtained from the recently introduced European Customer Satisfaction Index (ECSI), a Pan-European customer satisfaction measurement instrument.

The paper is organized as follows. Firstly, the paper presents the methodology behind the ECSI. Secondly, the ECSI pilot phase is described. Thirdly, the empirical study and results are presented.
2. The ECSI Model and Methodology

The successful experiences of the Swedish and American customer satisfaction indices (Fornell, 1992, Fornell et al., 1996, Anderson & Fornell (2000) have inspired creating a European Customer Satisfaction Index (ECSI), founded by the European Organisation for Quality (EOQ), the European Foundation for Quality Management (EFQM) and the European Academic Network for Customer Oriented Quality Analysis (IFCF), and supported by the European Commission (DG III). A pilot study during 1999 was implemented in 12 European countries, including Denmark.

The basic ECSI model (see Figure 1) is a structural equation model with latent variables. The model links customer satisfaction to its drivers, and in turn, to its consequence, namely customer loyalty. The drivers of customer satisfaction are perceived company image, customer expectations, perceived quality, and perceived value (“value for money”). Perceived quality is conceptually divided into two elements: “hard ware”, which consists of the quality of the product/service attributes and “human ware”, which represents the associated customer interactive elements in service, i.e. the personal behaviour and atmosphere of the service environment. The main causal relationships are indicated in figure 1, but actually there can exist many more points of dependence between the variables.

Figure 1. The basic ECSI model

The seven variables are seen as latent, i.e. non-observable. Each of the latent variables is described by two to six measurement variables (indicators), observed by survey questions to customers.

The latent variable customer satisfaction is measured through three indicators, empirically observed by the three questions, that have dominated theory and practice within customer satisfaction measurement (Ryan et al., 1995, p. 11-12). A customer satisfaction index is calculated by a weighted average of scores from the three questions. The use of multiple questions for each latent variable increases the precision of the estimate, compared to the use of a single question, and there is a lot of empirical support for using such
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Data for estimation of the model comes from data collected through telephone interviews from a national, representative sample of customers who are recent buyers and/or users of specific products and services. For most companies interviews are conducted with about 250 of their customers. The sample size has been determined by the following precision requirement: A 95% confidence interval for customer satisfaction (on a 0- to 100-point scale) should not be wider than ±2 points. Another accuracy requirement is, that $R^2$ of customer satisfaction should be at least 0.65, i.e. the model must be able to explain at least 65% of what drives customer satisfaction (ECSI Technical Committee, 1998, pp. 20-21).

The entire model is estimated using Partial Least Squares (PLS) (Fornell and Cha, 1994). The latent variables are calculated as weighted averages of their measurement variables, and the PLS estimation method calculates the weights in such a way that the resulting model has maximum explanatory power, i.e. maximum predictive power of the ultimate dependent variable customer loyalty.

For each company in the sample, the PLS method estimates indices for all the seven latent variables, i.e. customer satisfaction, loyalty and their drivers. Furthermore, the PLS method estimates the relationships within the entire model, i.e. the impacts between the latent variables (inner coefficients in the structural model) and the weights for each measurement variable associated with a latent variable (outer coefficients in the measurement model).

All seven latent variables are transformed from the original 1 to 10-point survey measures to 0 to 100-point scales, where zero means lowest possible (for example completely dissatisfied) and 100 means highest possible (for example completely satisfied). Estimation is made at the company level. Latent variable indices and impact scores at industry-level are calculated by aggregating company-level estimates, weighted by market share or other relevant indicators of size.

A major advantage of the ECSI is the use of generic questions, which are sufficiently flexible to be used across a wide variety of products, services, and public sector services, such as education, health care, etc. For a closer description of the generic questions see Kristensen et al. (2000).

3. The ECSI Pilot Study

12 European countries participated in the ECSI pilot study, and across Europe nearly 55,000 interviews have been carried out during the spring of 1999. All participating countries cover telecommunication, nearly all the countries cover retail banks and 5 countries cover supermarkets. Further information can be found at the IFCF website (www.ifcf.org).

In addition some participating countries included areas of particular interest to that coun-
try. In Denmark e.g. 30 companies within eight specific industries were included in the study, namely four telecommunication industries (fixed net, mobile phones, internet and cable television), retail banks, supermarkets, soft drink industry and fast food restaurants. Nearly 9,000 customers have been interviewed regarding their perceptions of quality and satisfaction with products and services in these industries. See Martensen et al. (2000). In Denmark the study was repeated in October 2000.

4. Some European Results

In the following section some of the results for satisfaction and loyalty in European retailing will be studied in more detail. We will analyse the drivers of customer loyalty on the macro level and we will try to identify some indicators that may explain some of the differences we see between the individual European countries.

Customer satisfaction and customer loyalty for European retailing 1999 are shown in figure 2. In total results for 5 countries are shown. It appears that customer satisfaction varies between 69 for France and 74 for Finland, while the lowest score for loyalty is 63 for France with Finland on top once again with a score of 79. It seems that the relationship between loyalty and satisfaction is slightly non-linear which indicates that the law of diminishing returns applies. As can be seen the relationship between the two constructs is nearly perfect, but of course we have to take into account that only five observations are available.

On the average the most important drivers of Customer Satisfaction and Customer Loyalty is Product Quality. Correlations between Product Quality, Customer Satisfaction and Customer Loyalty calculated across countries are significant at a 5% level of significance in these cases. In figure 3 we show the interrelationship between Customer Satisfaction and Product Quality.
Differences in private label penetration in the markets may be one possible explanation for the differences in perceived Product Quality. If many private label products are available on the market it leads to differences between stores but the overall picture may leave a more standardized impression. Private labels are traditionally perceived to be cheap me-too products. Hence we will expect perceived Product Quality to be negatively related to the level of private label penetration. Unfortunately it has only been possible to obtain data for member states of the EU and these data are from 1995. Private label penetration is at a much higher level now than in 1995, but the relative penetration across countries is expected to be unchanged compared to 1995.
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The tendency in figure 4 is quite clear and in good accordance with our hypothesis. In recent years a change in private labels have occurred with introduction of private labels whose quality matches or even exceeds that of brand-name goods, while still selling for a slightly lower price (Dunne&Narasimhan(1999)). Figure 4 indicates that introduction of private label products at such a high quality level has not so far changed the overall negative consumer perception of private labels.

5. Danish Results

In the following sections the Danish results will be studied in more detail. Firstly we want to examine the consequences of store ownership and store type on customer satisfaction and customer loyalty. Secondly we will try to explain differences in return on assets as a function of differences in store loyalty.

5.1. The Impact of Store Type and Store Ownership

In Denmark it is natural to divide the stores into two categories of ownership - private and co-operative ownership, and divide the types of stores into discount, standard supermarkets and hypermarkets. Both private and cooperative owners have stores in all three categories, which make analyses of main effects as well as interaction effects on loyalty and satisfaction possible.

It is the general opinion that the cooperative firm with a market share about 38%, partly due to member influence, has focused on products, leading to a large assortment of quality products, but with no clear market strategy on why consumers should buy the products. It is the assumption that the main strength of the cooperative firm is in the area of standard supermarkets, where the company is able to fulfill its traditional competencies, i.e. is assortment and service.

The private stores from which we report results, are owned by one private company. Over the years the private company has been able to build up an increasing market share, which at present is around 22 % of the market for convenience goods. In contrast to the cooperative firm, the private firm has been able to select the location of its stores without considering member interests. In its market strategy the private firm has been excellent in screening the assortment based on analyses of the best selling products resulting in low prices. At the same time the private company has emphasized the ‘why’-element by the value for money parameter. The private company mainly profiles itself by its discount stores and hypermarkets.

As a consequence of this overall description of the main actors on the Danish retail market for food our hypothesis is that the differences in image between privately owned stores and stores owned by a cooperative lead to higher customer loyalty and customer satisfaction for privately owned stores than for stores owned by a cooperative. This effect is expected to exist across store type but the size of the difference may differ with store type.
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The results for the image variable based upon the 2000 sample are illustrated in figure 4. It can be seen that the cooperative in general obtains a lower score on image than the privately owned company and especially in the discount market where the privately owned company has been very aggressive. Compared to 1999 where the image difference for supermarkets was not significant we find that the image problem for the cooperative firm is now a general phenomenon.

**Figure 5. Mean scores on the image variable as a function of type and ownership**

As a consequence of these differences in image scores we find significant differences in customer satisfaction and loyalty in private stores and stores owned by a cooperative as illustrated in figure 6. The importance of image for store loyalty has also been stressed in studies by e.g. Bloemer & deRuyter (1998) and Sirgy & Samli (1985). For customer loyalty the interaction effect is significant but not in the case of satisfaction. Compared to 1999 the difference between private and cooperative scores on loyalty and satisfaction in the supermarket segment has increased, the difference in the hypermarket segment is slightly decreased and in the discount market the position is unchanged. The improved position for the private firm in the supermarket segment is a warning signal for the cooperative firm, because this segment covers nearly 50% of total retail sales and as mentioned earlier the cooperative firm has built its present position on that segment.

**Figure 6. Mean scores for customer satisfaction and loyalty as a function of type and ownership**

The cooperative owner has tried to differentiate the standard supermarkets and hypermarkets from stores owned by the private company with a strategy focusing on products. It is obvious from these results that this strategy has failed. The private owned company has had a much higher success with the slogans stressing the store name and value for money.
Looking on the scores for the manifest variables forming the image variable we get an indication of the way the cooperative owner should work with the image problem. The 5 manifest variables are a) a trustworthy and reliable supplier b) a supplier with focus on customer demands c) a supplier where you get value for money d) a supplier characterized by creativity e) overall image. The most interesting owner effects are found for the variable c) and d) and the results are shown in figure 7.

Figure 7. Mean scores on two image variables as a function of type and ownership.

The first part of figure 7 shows that the cooperative owner is perceived to be more expensive than the competitor. This result is found for all store types and is probably a consequence of the strategy chosen by the competitor. The second part of figure 7 shows that especially the consumer perception of the players on the discount market differs. The impression is that the cooperative owner is perceived to be a more old fashioned supplier in that market.

6. Conclusion

The newly developed methodology behind the Pan-European customer satisfaction measurement instrument ECSI has been applied to the food retailing sector in selected European countries, and there are interesting results providing insight into the creation of customer satisfaction and customer loyalty.

We have seen quite large differences in customer satisfaction and loyalty between companies owned by cooperatives and companies owned by private companies in Denmark. It seems as if the cooperative companies are facing a very hard competitive situation and that may be part of the reason for the recent increased cooperation between the Danish cooperative company FDB and the Scandinavian sister companies – Coop Norway and KF in Sweden. According to FDB the vision for the group of the companies with a annual turnover equal to 1,2 billion US$ is to build a more customer oriented company culture with a more clear identity for each of the chains.

References

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