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TRUST AND LOYALTY IN RETAIL BANKING AND THE EFFECT OF THE BANKING CRISIS IN ICELAND

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ABSTRACT

It has been almost nine years since the three largest retail banks in Iceland went bankrupt in October 2008 and were taken over by the government. In this research, the focus is on the consequence of this crisis on customer trust towards their bank. The paper presents findings from four surveys, two before the banking crisis and two after the crisis. The surveys before the crisis are from 2006 (n=663) and 2007 (n=1,261) and the surveys conducted after the crisis are from 2013 (n=564) and 2016 (n=684).

The findings indicate that customers were more likely to connect trust to their own bank rather than another banks, both before and after the crisis, but especially afterwards. Therefore, the relationship between loyalty and trust might be of even higher importance when companies face a crisis or difficulties in their business environment. For banks in particular, the findings are of great interest because loyalty is of high importance for the financial sector. The most effective way to build trust seems to be focusing on the bank's own customers, which also builds trust for the industry as a whole.

Keywords: Customer trust; Customer loyalty, Banking crisis, Banking sector

1. INTRODUCTION

In this research, the objective is to evaluate the relationship between trust and loyalty before and after the 2008 banking crisis in Iceland. Loyalty is measured by likelihood of switching banks over the next six months and trust is one of the image attribute used in the survey. Previous research has revealed that customers did not switch banks more often than normal despite trust towards the banks plummeting dramatically following the banking crisis in October 2008 (see e.g. Gudlaugsson and Eysteinsson, 2010; Gudlaugsson and Eysteinsson, 2013).

Some explanations have been proposed to explain this event such as customers not having better alternatives because the entire banking system collapsed and that customers might have been “stuck” with their bank due to the high transaction cost of switching to another bank. In this research, an additional explanation is introduced. This explanation focuses on the relationship between loyalty and trust and posits that the reason for a customer remaining loyal after the level of trust towards their bank decreased is that they still trust their bank more than other banks. Based on this view, the following research question is put forward:

> **What is the relationship between trust and loyalty before and after the banking crisis in Iceland in 2008?**

Data from the four surveys conducted during this study were used to address the research question. Two surveys were conducted before the crisis, specifically February 2006 (n=663), or more than two years before the banking crisis, and February 2007, or more than one year prior to the crisis. The third survey was conducted across February and March 2013 (n=564), or more than four years after the banking crisis, and the fourth survey was administered in February 2016 (n=684), or more than seven years after the crisis. In all cases, the sample consisted of the bank's customers but a convenience sample was used. In addition, the market share of each bank based on the samples reflected the market share among the general population of interest. Though only four surveys were used in this research, it is worth mentioning that these surveys were implemented in similar ways since 2003 because the main objective of the project was to evaluate the image of banks in Iceland.

The paper is divided into four sections. The first part presents the state of knowledge focusing on trust, loyalty, and the relationship between these two concepts. The second part details the methodology, data analysis, and results. Finally, the third part presents a discussion about the findings.

2. LITERATURE REVIEW

Several researches focusing on the consequences of the banking crisis in Iceland and its impact on the image of the banks have been published (Eysteinsson and Gudlaugsson, 2011; Gudlaugsson and Eysteinsson, 2010; Gudlaugsson and Eysteinsson, 2013). The results from these studies demonstrate lower levels of trust in the banks compared to periods before the crisis without a connected lower level of loyalty.

Loyalty is an important concept in branding and marketing (Helgesen and Nesset, 2007; Zeithaml, Bitner and Gremler, 2009; Zinkham, 2001) and its importance is connected to building loyal customers, which is important as it is typically less expensive to retain existing customers than to attain new ones (Kotler, Armstrong, Saunders and Wong, 2001; Zeithaml, Parasuraman and Berry, 1990).

Loyalty can either be defined from a behavioral perspective (Keiningham, Aksoy, Cooil and Anreassen, 2008) or an attitude perspective (Boulding, Kalra, Stealin and Zeithaml, 1993; Helgesen and Nesset, 2007). The behavioral perspective focuses on repeat purchasing of a product or service. However, the problem with this definition is that customers may not have other alternatives (Ozimek, 2003) and are therefore in some way “stuck” with their service provider. The other perspective focusing on attitude is based on how willing customers are to recommend a product or service to others when asked whether they like the company and its offerings and generally hold a positive attitude towards its contributions.

Research has demonstrated that trust is important in business activities because of its positive relationship with (and potential cause of) loyalty. Sirdeshmukh and Sabol (2002) have developed a framework for better understanding the behaviors of service providers that build trust and what instruments convert consumer trust into value. In their findings, the authors conclude that the frontline employees, as well as the management policies, play an important role in the trust-loyalty relationship. Likewise, Macintosh and Lockshin (1997) investigated the relationship between frontline staff, such as salespeople, and customers. They focused on the relationship between two types of trust, namely trust towards the salespeople on the one hand and in-store on the other. Their findings highlighted both direct and indirect multi-level relationships between these two types of trust. Both frontline and in-store staff had a positive relationship on loyalty measured either as an attitude or purchases intention. Flavián, Guinalíu and Gurrea (2006) investigated the influence of trust and usability on loyalty to websites. Their findings indicate that both usability and trust have a positive effect on website loyalty through higher degrees of consumer satisfaction. Lau and Lee (1999) studied the effect of trust on brand loyalty and their findings indicate that several brand characteristics have positive effects on consumer trust towards brand and that there is a positive relationship between trust towards brand and brand loyalty. In addition, Palmatier, et al. (2006) studied factors that influence the effectiveness of relationship marketing. Their findings indicate that relationship marketing positively affects performance, especially when the relationships are more critical to customers. These critical factors were, for example, service offerings and channel exchanges where trust is of high importance.

In the banking industry, this also seems be the case but research has demonstrated that the relationship between trust and loyalty is strong. Deb and Chavali (2010) investigated the significance of trust and loyalty during the financial crisis and their findings indicated that shared values and opportunistic behavior played dominant roles in customer trust and trust was a strong moderator to loyalty through lack of price sensitivity. Hazra and Srivastava (2009) studied the relationship between service quality and customer loyalty, commitment, and trust. Results revealed that service quality is a significant predictor for both customer trust and loyalty and the relationship between trust and loyalty is strong. Hoq, Sultana, and Amin (2010) investigated the role of customer trust on customer loyalty and results indicated that high levels of trust lead to enhanced customer loyalty. Kantsperger and Kunz (2010) have developed a conceptual model of consumer trust based on empirical data collected from a sample of 232 retail bank customers and their findings demonstrate that of two dimensions of trust, benevolence and credibility, benevolence has a significantly greater influence on loyalty. Lewis and Soureli (2006) studied loyalty in retail banking and their findings highlight that one of the main antecedents of bank loyalty is trust as well as service quality, satisfaction, and image. Likewise, Tariq and Moussaoui (2009) examined the main antecedents of customer loyalty in the banking sector. Their findings indicate that trust is an important factor affecting customer loyalty and customer satisfaction, corporate image, and service quality. Finally, Ball, Coelho and Machás (2004) investigated the relationship between loyalty, trust, and communications and revealed that loyalty can be explained by these factors. Based on the existing literature, it can be strongly argued that trust is important for customer loyalty in retail banking and a decline in trust can affect the level of loyalty.

3. METHODOLOGY AND RESULTS

The current research is based on four datasets, two obtained before the banking crisis in Iceland in October 2008 and two after the crisis. The surveys before the crisis are from 2006 (n=663) and 2007 (n=1,261) and the surveys after the crisis are from 2013 (n=564) and 2016 (n=684). All surveys were conducted as Internet-based surveys and a convenience sample was used. In all cases, the market share of each banks based on the samples mirrors the market share among the general population. The surveys were part of a longitudinal project where the goal was to evaluate the image of banks in Iceland from 2003 (a period of 16 years) and were all executed in the same way.

In all cases, it was investigated whether trust was significantly different according to where participants carried out their banking. An ANOVAs was used to determine whether participants had more trust towards their own bank than other banks.

Findings are divided in accordance with where the customers conducted their banking. Only results for the three largest banks, i.e. Arion banki (AB), Islandsbanki (IB), and Landsbanki (LB) are detailed because the number of answers received for the other banks were insufficient for analysis. Importantly, two of the banks included in the analysis changed their name after the crisis. AB’s former name was Kaupthing and IB was originally called Glitnir. In all references to these banks in this study, the current names are used. Notably, the banks investigated in this study held about 86% market share in retail banking before the crisis but held 90 to 95% of the market share after the crisis. The reason for this increase is due to the largest Savings&Loans merging into these three banks after the banking system collapsed. In the surveys the participants were asked how strongly they connect the concept of trust to certain banks using 9-point scale where (1) applies very badly to this bank and (9) applies very well to this bank. Table 1 provides the average values of trust, as well as the 95% confidence interval, towards the three banks in 2006.

TABLE 1: TRUST IN BANKS IN 2006

	Mean value	95% Confidence	
		Lower	Upper
Average	6.26	6.18	6.35
LB	6.99	6.85	7.13
IB	6.80	6.69	6.92
AB	6.11	5.98	6.23

The average level of trust in the banks in 2006 was 6.26 (+/- 0.08) and because the scale was from 1 to 9 this number is a rather high value, which implies that generally the industry was considered trustworthy. LB had the highest score of 6.99 (+/-0.14), the score for IB was 6.80 (+/- 0.11), and AB had the lowest score of 6.11 (+/- 0.13). In 2006, 8% (+/-2.07%) of the participants considered it likely or very likely that they would switch banks within the next 6 months. LB had the lowest score of 4.6%, which was in line with its highest score of trust. IB had the highest score of 9.6%. Table 2 presents the average values of trust, and the 95% confidence interval, in 2007.

TABLE 2: TRUST IN BANKS IN 2007

	Mean value	95% Confidence Lower	Upper
Average	6.17	6.10	6.23
LB	6.89	6.79	6.99
IB	6.59	6.51	6.68
AB	6.05	5.96	6.14

As presented in Table 2, the scores for 2007 were notably similar to the 2006 scores. The average level was 6.17 (+/- 0.07) and as in 2006, LB had the highest score (6.89; +/- 0.1) and AB the lowest (6.05; +/- 0.9). In 2007, 9.5% (+/- 1.67%) of respondents considered it likely or very likely that they would switch banks within the next 6 months, and as in 2006, LB had the lowest score of 4.9% but AB had the highest score of 11.9%. As can be observed in Tables 1 and 2, the level of trust towards those three banks was relatively high and participants considered it rather unlikely that they would switch banks within the next 6 months. Table 3 provides the average values of trust, as well as the 95% confidence interval, for the three banks in 2013 or 5 years after the banking system collapsed.

TABLE 3: TRUST IN BANKS IN 2013

	Mean value	95% Confidence Lower	Upper
Average	4.09	3.94	4.25
LB	4.26	4.07	4.46
IB	4.36	4.17	4.55
AB	4.01	3.81	4.21

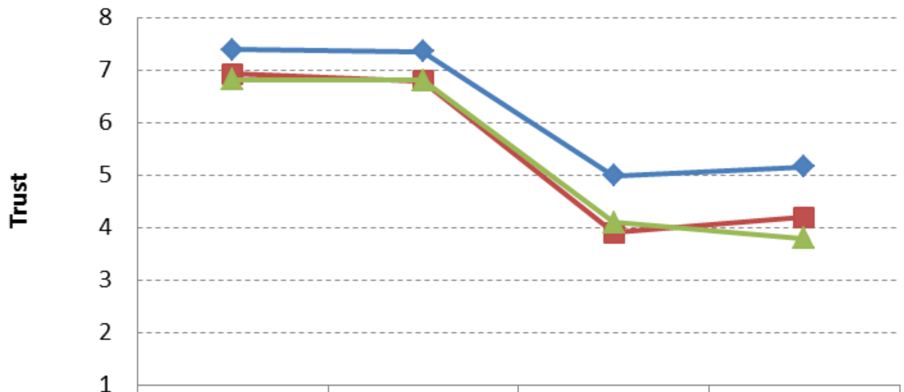
The average level of trust towards the banks in 2013 was 4.09 (+/- 0.15), which is considerably lower than it was before the crisis. This finding also reveals that even 5 years after the crisis, the banks were still struggling to regain the trust level they had before 2008. For the individual banks however, the trust values were similar. IB had the highest score of 4.36 (+/- 0.19), LB had the score of 4.26 (+/- 0.19), and AB had the lowest score of 4.01 (+/- 0.2). In 2013, 10.6% (+/- 2.55%) of respondents considered it likely or very likely that they would switch banks within the next 6 months and 7.6% stated that they had switched bank in the last 6 months. Although the percent of those who considered likely that they would switch banks in 2013 was higher than in 2006 and 2007, the difference was not significant, which is of interest since the level of trust was significantly lower after the crisis. In Table 4, the values for trust in 2016 are presented.

TABLE 4: TRUST IN BANKS IN 2016

	Mean value	95% Confidence Lower	Upper
Average	4.24	4.09	4.38
LB	4.37	4.19	4.56
IB	4.51	4.34	4.69
AB	4.06	3.89	4.23

The value for trust in 2016 was higher but similar to numbers in 2013 but significantly lower than before the banking crisis in 2008. The average score was 4.24 (+/- 0.15) and as in 2013, IB had the highest score (4.51; +/- 0.17), and AB had the lowest score (4.06; +/- 0.17). AB also had a significantly lower score than IB. In 2016, 8.7% of respondents considered it likely or very likely that they would switch banks within the next 6 months and 7.8% said that they had switched banks in the last 6 months, which was similar to findings in 2013. This figure was slightly higher than the average figure the years before the crisis but the difference was not significant. Therefore, it might be concluded that the relationship between trust and loyalty in the banking industry in Iceland is weak and other factors can explain the relatively constant level of loyalty before and after the crisis.

Figure 1 illustrates the level of trust towards LB according to where the participants in the surveys carried out their banking. As can be observed in these findings, LB received its highest score from its own customers and interestingly, the difference between the customer groups was larger after the crisis than before it.

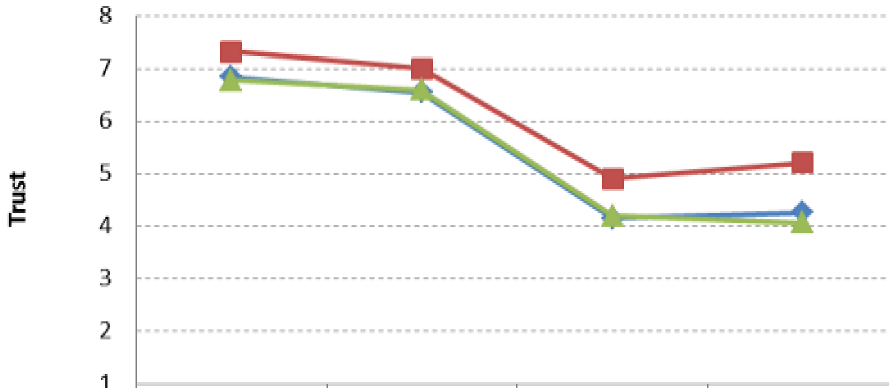


	2006	2007	2013	2016
LB-C	7,39	7,35	4,99	5,16
IB-C	6,93	6,79	3,9	4,19
AB-C	6,81	6,8	4,1	3,79

FIGURE 1: COMPARISON OF TRUST TOWARDS LB

An ANOVA was used to analyze the survey data and the results for 2013 indicated a difference ($p<0.05$) between groups [$F(2, 511)=10.319$, $p=0.000$]. A post-hoc test (Tukey) revealed differences between LB-C ($M=4.99$, $SD=2.56$) on the one hand and IB-C ($M=3.9$, $SD=2.30$) and AB-C ($M=4.10$, $SD=2.21$) on the other. The Eta squared (ES) value was 0.04, which indicates that the effect size of the group (each bank's customers) was between weak and moderate (Cohen, 1988). This finding means that 4% of the variability in trust was related to the group. The results for 2016 presented similar values [$F(2, 639)=18.389$, $p=0.000$] and the difference between LB-C was ($M=5.16$, $SD=2.60$), IB-C ($M=4.19$, $SD=2.26$), and AB-C ($M=3.79$, $SD=2.29$). The ES was similar at 0.05.

Figure 2 illustrates the level of trust towards IB according to where the participants conducted their banking. As in the case of LB, IB received its highest score from its own customers and after the crisis the difference was larger than before.

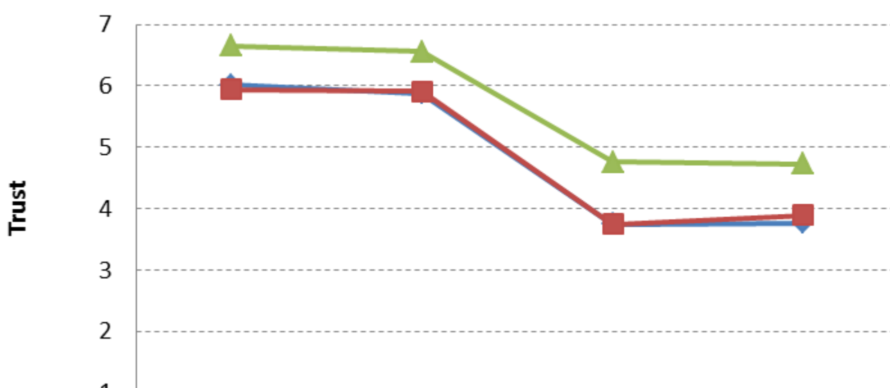


	2006	2007	2013	2016
LB-C	6,84	6,55	4,14	4,25
IB-C	7,31	7	4,9	5,2
AB-C	6,78	6,59	4,19	4,06

FIGURE 2: COMPARISON OF TRUST TOWARDS IB

As was the case of LB, an ANOVA was performed for the years 2013 and 2016. The results for 2013 revealed a difference (p<0.05) between group [F(2, 509)=5.952, p=0.003] and the difference between IB-C was (M=4.90, SD=2.45), LB-C (M=4.14, SD=2.28), and AB-C (M=4.19, SD=2.17). The ES value was 0.02. For 2016, there was also a difference (p<0.05) between groups [F(2, 634)=15.729, p=0.000] where IB-C (M=5.20, SD=2.37) had a higher score than LB-C (M=4.25, SD=2.17) and AB-C (M=4.06, SD=2.22). The ES value was 0.05.

Figure 3 illustrates the level of trust in AB based on where the participants carried their banking. As in the case of LB and IB, AB received its highest score from its own customers.



	2006	2007	2013	2016
LB-C	6,02	5,88	3,75	3,77
IB-C	5,94	5,91	3,75	3,89
AB-C	6,65	6,56	4,76	4,73

FIGURE 3: COMPARISON OF TRUST TOWARDS AB

The results for 2013 indicated a difference (p<0.05) between groups [$F(2, 510)=10.277, p=0.000$] and the difference between AB-C was (M=4.76, SD=2.60), LB-C (M=3.75, SD=2.28), and IB-C (M=3.75, SD=2.17). The ES value was 0.04. For 2016, there was also a difference (p<0.05) between groups [$F(2,$

637)=10.907, p=0.000] where AB-C (M=4.73, SD=2.44) had a higher score than LB-C (M=3.77, SD=2.08) and IB-C (M=3.89, SD=2.12). The ES value was 0.03.

5. DISCUSSION AND CONCLUSION

The findings presented in this study indicate that although trust towards the Icelandic banks decreased extensively following the banking crisis in 2008 the banks' customers did not switch banks at a higher rate than before the crisis. The most common explanations provided for this trend are that all major banks collapsed and therefore customers did not have obvious alternatives to choose from, and that the customers were in some sense "stuck" with their bank because of financial obligation towards the banks and high transaction costs when switching to another bank.

In this paper, a third explanation is proposed, which states that customers trust their bank more than other banks, even though the level of trust plummeted during the crisis, and had no strong reason to switch to a different bank. Therefore, the reason for not switching banks may not necessarily be some kind of forced choice, but instead a decision based on the level of trust the customer has towards their bank.

The research question focuses on the relationship between trust and loyalty and how crisis affect these two concepts. The findings indicate that customers are more likely to connect trust to their own bank rather than other banks. Additionally, banks receive their highest trust score from their customers. The findings also demonstrate that after the crisis the difference between scores for trust was in all cases higher than before the crisis, which indicates that after crisis the relationship between loyalty and trust might have been of higher importance than in a normal year. The customers of LB, for example, rated their own bank a score of 7.39 in 2006 and 7.35 in 2007 but only 4.99 in 2013 and 5.16 in 2016. The score for trust for LB customers towards LB was significantly lower after the crisis than before it and in 2013, LB customer rated IB only 4.14 for trust and AB 3.75. In 2016, customers rated IB 4.14 and AB 3.77. Although the level of trust of LB customers towards their bank plummeted, the rate for the other banks was worse. Such findings were similar for the other banks.

This finding is important because although the average score for trust dropped significantly, the banks still received their highest value from their own customers. Also of note was the difference between the score the banks obtained from their own customers being significantly higher than the scores these customers ascribed to other banks. Based on these findings, it is argued that in general, customers trust their own bank more than they trust other banks. This sentiment was the case both before the crisis when the level of trust was relatively high and also when the trust towards theirs bank decreased following a crisis.

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