CUSTOMER ORIENTATION AND BUSINESS PERFORMANCE IN COMMUNITY BANKS: A FIVE YEAR COMPARISON

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Abstract:

Prior studies involving the influence of market orientation on enhanced business performance have shown mixed results. The purpose of the 2011 study was to determine if over the five year period since the 2006 study, the market orientation of community banks in relationship to their business performance had changed. The authors theorized that this inconsistency may be caused by the investment in a market orientation having a diminishing returns when measuring enhanced business performance. To this end authors surveyed community oriented commercial banks in six states. The authors used the responses of the individual bank's CEOP as a proxy for the senior management measure of a commitment of market orientation. They used audited numbers from audited financial statements submitted by the individual banks to their governmental regulators to compute a return on assets which was used as the measure of business performance. The result of the study concluded that there was indeed a point of diminishing return on assets when investing in marketing orientation and identified such a point using a seven point scale. The point of diminishing return was also identified for each of three components of market orientation using the same scale. It appeared that those banks who tended to control their customer orientation in the 2006 time frame, were better positioned to be successful in the stressed economic times. The participating banks corporate culture, relative to the value of a portion of its customer base that was unprofitable or marginally profitable, and the bank's willingness to move away from these customers, and their propensity to show profit level not enjoyed by their competitors, allows for their survival today.

Key words:

diminishing return on assets,
customer orientation,
community bank performance,
marketing orientation,
competitor orientation.

INTRODUCTION

These are interesting days for bankers and their banks. Customers are demanding ever more at lesser cost. Competition is coming from all points on the financial services compass. Shareholders are seeking increased returns on their investment in bank equities. In addition, the financial regulators are demanding that capital be increased thus putting pressure to

increase earnings. Additionally, consolidation is at a rapid pace either through their own direction or at the discretion of the Federal and State regulatory authorities. It is into this fray that the authors of this article journeyed to determine at what point customer orientation and being influenced by competitors detracted from the ability of a bank to maximize its profitability, as measured by Return on Assets, and thus meet the requirements and demands of the shareholders and the financial regulators.

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Prior to 2006, studies have shown an inconsistent relationship between market orientation and enhanced business performance. Numerous researchers have addressed this issue with mixed results. (Jaworski and Kohli, 1993; Narver and Slater, 1990; Desphandé et al. 1993; Avlonitis and Gounaris, 1999; Chang and Chen, 1998; McNaughton et al. 2002). Some studies showed a slightly positive relationship between two of the three factors and levels of profitability, while other studies concluded there was no relationship. This has led the authors to conclude that perhaps there was a point of diminishing returns when it came to customer orientation and concerns over competitive factors. To the knowledge of the authors, no research has been conducted to investigate at what point, if any, there is a diminishing return on an investment in market orientation. In the attempt to better understand the relationships between the factors of a customer and competitive orientations and profitability, the authors conducted two studies of the community banking industry in 2006 and 2011.

PURPOSE OF THE STUDY

The purpose of the 2011 study was to determine if, over the five year period since the 2006 study, the marketing orientation of community banks in relationship to their business performance had changed. The findings of the study will provide insight into current banking perceptions and provide an overview of those changes from 2006 to 2011.

PROBLEM AND ITS BACKGROUND

For the purposes of this study market orientation is defined by Narver and Slater (1990). From an extensive review of the literature, Narver and Slater (1990) inferred that there are three behavioral components and two decision criteria that comprise market orientation. The three behavioral components are customer orientation, competitor orientation and inter-functional discipline. The two decision criteria are long term focus and profitability. The authors define customer orientation as “the sufficient understanding of one’s target buyers to be able to create superior value for them continuously” (Narver and Slater, 1990, p. 21). Competitor orientation is defined as the “seller’s understanding of the short-term strengths and weaknesses and long-term capabilities and strategies of both the key current

and key potential competitors” (Narver and Slater, 1990, p. 21). Inter-functional discipline is defined as “the coordinated utilization of company resources in creating superior value for target customers” (Narver and Slater, 1990, p. 22). This study examines the relationship between market orientation, its three behavioral components and enhanced business performance, as measured by return on assets in the community banking segment of the commercial banking industry.

The investigators looked at the three behavioral components of market orientation. These are: customer orientation, competitor orientation and inter-functional coordination. Based on these components of customer orientation four hypotheses were developed.

- H1 There is a positive and significant relationship between market orientation and return on assets.
- H2 There is a positive and significant relationship between customer orientation and the return on assets.
- H3 There is a positive and significant relationship between competitor orientation and the return on assets.
- H4 There is a positive and significant relationship between inter-functional coordination and return on assets.

POPULATION

The surveyed population consisted of CEOs of community banks in several southeastern states. The homogeneity of the sample was a plus in reducing the impact of extraneous factors. Also, the time frame selected for the 2006, study precluded the current economic turmoil and was considered by the authors to be a period of normal economic activity. The 2011 time frame for the second study is in the midst of an economic downturn of severe proportions.

Community banks and savings associations in Florida, Georgia, Tennessee, North Carolina and Virginia comprised the study population in 2006. A total of 926 institutions were selected from the directories published by the various state bankers’ associations. In 2011 Community banks and savings associations in Florida, Georgia, Tennessee, North Carolina, Virginia, and Alabama comprised the study population. A total of 695 institutions were selected from the 2010 directories published by the

	2006	2011	Returned Mail or No Longer in Business	Total	Percent Change from 2006 to Present
Florida	246	167	-19	148	-40%
Ga.	408	243	-22	221	-46%
N.C.	92	79	-10	69	-25%
Tn.	181	139	-17	122	-33%
Va.	81	67	-9	58	-28%
Total by State	1008	695	-77	618	-39%

Comparison of the Number of Community Banks by State 2006 and 2011

same state bankers associations. Below is a comparison of the number of banks surveyed in each state in 2006 and 2011.

QUESTIONNAIRE DESIGN AND SCALING

A self-administered modified twenty question Narver and Slater (1990) customer orientation survey instrument was utilized for the study. The questionnaire used a scale of 1 to 7, where 1 represented “not at all” and 7 represented “to an extreme extent”. Additionally, interviewees were asked a matrix of open ended questions about their respective banks total assets, total capital, and profit after taxes for a three year period. These figures were obtained or derived from audited financial reports filed with each of the bank’s appropriate governmental regulators.

A total of 926 survey questionnaires were sent in 2006 via US Postal Service first class mail with a cover letter and a stamped self-addressed return envelope. No compensation or inducement was offered to the survey participants. A total of 221 survey questionnaires were returned. Of the 221 questionnaires returned 40 lacked data and 19 were from banks that suffered financial losses during the time frame studied, which eliminated these questionnaires from the study. The remaining 162 usable questionnaires resulted in 17.5% response rate.

A total of 816 of the same survey questionnaires were sent in 2011 via US Postal Service first class mail with the same direc-

tions and self addressed return envelope. The same states were surveyed in 2006 and 2011. Alabama was added due to the diminishing number of community banks in the states previously surveyed. Eighty-eight surveys were returned due to no longer in business. A total of 116 usable surveys were returned. The response rate was 16%.

ANALYSIS

In 2006, descriptive statistics and other statistics were analyzed, which comprised several steps. Strong linear correlations were found between market orientation and return on assets in the scale range surrounding 4.5. In 2011, this number was reduced to 4.0 on a 7 point scale.

Customer orientation comparison 2006 to 2011

RESULTS

Customer Orientation

The 2006 results indicated that beyond a certain point, the additional investment in customer orientation yielded a negative return. This point, for the banks that participated in both the 2006 and 2011 studies was 4.5 on a 7 point scale, which equated to a “more than moderate (4.0)”, but “less than considerable (5.0)” In summary, an investment beyond a “more than moderate level” yielded a negative return.

The 2011 study indicated the same basic results, however the level of customer orientation decline to 4.0 on the same 7 point scale. This decline in customer orientation during these stressful economic times could be the result of a number of factors.

Bank regulatory authorities are pressing banks to improve their capital ratios. This can be done in three ways. First, the bank can issue equity. However in this environment of reduced stock prices most banks, and their shareholders, have little desire to incur the dilution of earnings and ownership that this option affords.

Second, the bank can increase its retained earnings (i.e. its capital accounts), by generating more earnings via operational efficiencies and effectiveness. This can be accomplished by driving away those customers whose total banking relationships are either not profitable or are minimally profitable. This reduction in customer accounts to be serviced allows for a reduction in staffing levels, along with all other expenses associated with servicing those accounts that do not meet profitability standards.

And third, the reduction in customers means that their deposit accounts are moved to other financial institutions, thus reducing the degree of financial leverage, which is tantamount to improving the capital position of the bank in question.

The combination of the second and third points, thus reflect the findings of the 2006 study that showed beyond a certain point of customer service the business performance declines. Those banks that survive today, i.e. to participate in the 2011 study, are not only profitable, to some degree or another, but are also able to address the concerns regarding capital expressed by the bank regulatory authorities.

Competitor Orientation

The 2006 findings and the results of the 2011 survey show no positive relationship between competi-

tor orientations and enhance business performance. This is possible because banks and bankers are more concerned with an internal orientation and less concerned with the external environment as it relates to competing banks. Anecdotaly, on several of the returned Survey Instruments, the responding executive noted that there was limited concern about competitors as the bank in question was “trying to survive”.

Inter-functional Discipline

As in the 2006 study, the 2011 study found no positive relationship between Inter-functional Discipline and enhance business performance. This consistency of the findings would seem to be even more evident as the internal Inter-functional capabilities of the bank would be stressed to an even great extent by two factors. The first factor would be the staffing reductions noted earlier in the paper. The second factor is the distinct possibility that some of the banks included in the study population, may have absorbed “problem” banks at the request of the FDIC and other bank regulators. The combining of corporate cultures, software systems, human resource departments, etc would surely seem to have a negative impact upon Inter-functional Discipline within the bank.

CONCLUSION

It appears to the authors of this study that those banks who tended to control their customer orientation in the 2006 time frame, were better positioned to be successful in these stressed economic times. The participating bank’s corporate culture, relative to the value of a portion of its customer base that was unprofitable or marginally profitable, and the bank’s willingness to move away from these customers, and their propensity to show profit levels not enjoyed by their competitors, allows for their survival today.

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ORIJENTACIJA KA POTROŠAČU I POSLOVNE PERFORMANSE LOKALNIH PRIVATNIH BANAKA U RAZDOBLJU OD 2006. DO 2011.

Rezime:

Ranija istraživanja o uticaju tržišne orijentacije na poboljšanje poslovne performanse su imala različite rezultate. Autori rada smatraju da je do te nedoslednosti došlo zbog toga što investiranje u tržišnu orijentaciju ima tačku smanjenja stope prinosa pri merenju poboljšanih performansi.

Zbog toga su autori rada istražili manje lokalne privatne banke (community banks) u pet država SAD. Autori su koristili odgovore pojedinih direktora banaka kao meru posvećenosti viših menadžera tržišnoj orijentaciji. Koristili su cifre iz revizijskih finansijskih izveštaja koje su banke slale u poresku upravu radi računanja poreza na prihode, to je bilo upotrebljeno kao mera poslovnog uspeha. Rezultati istraživanja pokazuju da zaista postoji moment smanjenja stope prinosa pri investiranju u tržišnu orijentaciju, kojeg su autori identifikovali uz upotrebu skale sa sedam nivoa. Tačka smanjenja stope prinosa je takođe identifikovana za svaku od tri komponente tržišne orijentacije uz upotrebu iste skale.

Ključne reči:

smanjena stopa prinosa, klijentska orijentacija, učinak lokalnih privatnih banaka, tržišna orijentacija, konkurenta orijentacija.

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