AN INVESTIGATION INTO SWITCHING BARRIERS: THE CASE OF INDIVIDUAL INVESTORS VERSUS INSTITUTIONAL INVESTORS

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ABSTRACT

This paper examines the extent to which both individual and institutional investors would switch from one stockbroker to another and the factors that would encourage them to stay loyal with their brokers. A sample of 131 individual investors and 28 companies were successfully interviewed through the mail survey technique over a two-month period. It was found that switching costs and barriers were an obstacle for individual investors to switch to other stockbrokers while for institutional investors, these did not represent an obstacle to switch to alternative stockbrokers.

INTRODUCTION

The stockbroking industry is a service-oriented industry where brokers act as agents for investors when a security is bought or sold and are compensated with a commission. Stockbroking is a competitive business where investors would not hesitate to switch to alternative brokerage houses if they do not obtain satisfaction. Providing quality service and hence customer satisfaction should thus be recognised as a key strategy and a crucial element of long-run success and profitability for stockbroking businesses.

LITERATURE REVIEW

Colgate and Lang (2001) categorise switching barriers into relational investments, switching costs, service recovery and availability and attractiveness of alternatives. Gwinner *et al*. (1988) argued that customers derive superior valued benefits when they commit themselves to developing and maintaining relationships with a specific service provider. Switching costs has been defined as the cost of changing services in terms of time, monetary and psychological costs (Dick and Basu 1994; Guiltinan 1989; Sengupta *et al*. 1997). Switching costs also relate to perceived risk which can be defined as the consumer's perception of the uncertainty and adverse consequences of buying a product or service (Dowling and Staelin 1994).
Perceived risk has six components:

1. Financial risk – will the product be worth all the costs involved?
2. Performance risk – how well will the product work?

3. Social risk – how will the consumers' image, as seen by friends, peers, etc. be affected after the purchase?
4. Psychological risk – how will the purchase of the product affect the consumer's self-esteem or self-concept?
5. Physical risk – will the product harm the consumer?
6. Time/convenience loss – the waste in time, convenience and effort of getting the product adjusted, repaired or replaced (Garner 1986; Mitchell and Greatorex 1993).

Service recovery comprises of all the activities and efforts employed by a service organization to rectify, amend and restore the loss experienced by the customer following a service failure (Gröonroos 1988). After experiencing a problem and complaining about it, customers may stay with the service provider if they were satisfied with the service recovery process. Customers may also remain in a relationship if they perceive few alternatives (Bendapudi and Berry 1997) in the market or lack of superior competition in the marketplace (Anderson and Narus 1990).

Switching costs are high for services high in credence properties, that is where the customer typically has difficulty evaluating the quality of what they have received due to lack to technical expertise, or for which there is a limited number of suppliers (legal services, management consulting and medical services) (Brown and Swartz 1989; Patterson and Johnson 1993).

In Sharma and Patterson's (2000) model, they tested a framework which presented alternative attractiveness and product-norm experience as moderators of the relationship commitment and its key antecedents (trust and service satisfaction) in the context of a personal financial planning service. They found that switching costs acted both as a moderator as well as an independent antecedent of relationship commitment. Ruyter *et al.* (1998) examined the relationship between service quality, service loyalty and switching costs across five service industries. When testing their model, switching costs was found to be both an independent variable and a moderator. They also found that customers will be less loyal both in the preference and price indifference sense in industries characterised by low switching costs than in those with relatively high switching costs implying that service providers should take actions that increase switching costs for their customer such as establishing preferred customer programmes. The relationship between service quality and price indifference loyalty was in fact strongest for high switching cost industries (city theatres and health centers) than for low switching cost industries (amusement parks, fast food and supermarkets). This would imply that the same increase in perceived service quality as a result of quality improvement efforts has more effect in some industries than others. Alternatively, companies operating in service industries with high switching costs in which the impact of quality on loyalty is relatively strong are also more vulnerable to decreases in perceived quality levels and hence service quality levels should be carefully controlled in service industries with high switching costs.

Patterson et al. (2001) used high and low psychological switching costs as moderators to examine the relationship between service quality and satisfaction in four service industries: medical, auto servicing, hairdressing and retail banking. The results showed that switching costs had a strong impact on the relationship between technical and functional quality, and satisfaction. Their findings implied that when strong social bonds have been established with a service provider, the quality of the delivered service can drop without the customer satisfaction level being negatively affected.

Since institutional investors were considered more experienced and have an obligation towards their Company and a responsibility for financial results, it was expected that they would not have much difficulty to switch stockbrokers despite switching costs and barriers as opposed to individual investors who will find it much more difficult to switch to another stockbroker because of the switching costs and barriers. Hence, the following hypotheses are thus advanced.

H_{1a}: Switching costs and barriers are not an obstacle in the decision of institutional investors to switch stockbrokers.

H_{1b}: Switching costs and barriers are an obstacle in the decision of individual investors to switch stockbrokers.

METHODOLOGY

Before the questionnaire was constructed, several in-depth interviews with investors were conducted so as to develop an understanding of their behaviour when it comes to switching factors.

The questionnaire was basically structured – consisting of a series of 7-point itemised, labelled, Likert type statement – to determine variations in extent, with the final demographics section including sex, age, marital status, ethnic group occupational status, level of education and gross monthly household income for individual investors and sex, age, occupational status, number of employees, annual turnover, number of years in business, affiliation and level of education for institutional investors. The labelled scale was chosen because, as Lewis (1993) recommends, the use of such a scale prevents the use of extreme ends. Also, an argument raised by Babakus and Mangold (1992) suggests that such scales minimise respondents' frustration.

The population was defined as all individual and institutional investors who had invested in the stock market over the past twelve months. 50 questionnaires were dispatched to companies and 250 individual investors were targeted.

The mail survey technique was used for the purpose of this study. The survey instrument was accompanied by a stamped, self-addressed envelope with the researcher's address and all these were sealed in an envelope. The data collection occurred over a two-month period. As regards institutional investors, 28 survey instruments duly completed were returned, yielding a response rate of 56%. As for individual investors, 131 questionnaires were returned, representing a response rate of 52.4%. No questionnaires were discarded.

RESULTS

Findings for individual investors in **Table 1** show that 52.7% of the respondents were male investors and 47.3% were female investors. The majority of the investors (45.1%) came from the age group 30-49 years old while 26.7% were aged 18-29 years old. Most of the investors were married with children (57.3%) and the majority of them belonged to the Hindu community (58%) followed by the Chinese community (23.7%). This last finding was particularly interesting since the Chinese community represents only 0.7% of the Mauritian population according to the 2000 Census conducted by the Central Statistics Office of Mauritius (2003). Thus, the Chinese community seemed to be very active in transacting stocks.

Moreover, 40.5% of the investors were holders of an undergraduate degree whereas 25.2% of them hold a postgraduate degree. All respondents had gone beyond primary level education. Most of the investors (55.7%) drew a gross monthly household income before income taxes of below Rs 30,000 followed by those whose income ranged between Rs 30,001 and 60,000 (39.7%) and at least 64.9% of them held administrative, managerial, professional and executives positions in their jobs.

Table 1: Demographic Profile of Individual Investors (n=131)

Demographic Variables	**Percentage (%)**
Gender	
Male	52.7
Female	47.3
Age	
18-29 years old	26.7
30-49 years old	45.1
50-64 years old	24.4
65 years or older	3.8
Marital Status	
Single	21.3
Married without children	21.4
Married with children	57.3
Ethnic Group	
Hindu	58.0
Muslim	13.7
Chinese	23.7
Other	4.6
Occupational Status	

Blue Collar	6.1
White collar	3.8
Administrative/Managerial/Professional/Executives	64.9
Retired/student/housewife	14.5
Others	10.7
Education	
Primary	0
Secondary	22.1
Diploma	12.2
Undergraduate degree	40.5
Postgraduate degree	25.2
Monthly Household Income Before Taxes	
Below Rs 30,000	55.7
Rs 30,001 – 60,000	39.7
Rs 60,001 – 90,000	3.1
Above Rs 90,000	1.5

Moreover, results shown in **Table 2** indicate that the majority of the institutional investors were male (89.3%) and only 10.7% were female investors. 53.6% of the respondents were in the age group 30-49 years old and the same percentage held top management position in their companies. As far as the educational spread of respondents was concerned, most respondents (67.9%) in the sample had received postgraduate education.

The majority of the companies who participated in this survey employed less than 50 employees (32.1%), 48.1% of them had an annual turnover of between Rs. 501 – 1000 million and 35.7% were in business for 21-30 years. Finally, 96.4% of these companies had local affiliation and only 3.6% were foreign.

Table 2: Demographic Profile of Institutional Investors (n=28)

Characteristics	**Percentage %**
Gender	
Male	89.3
Female	10.7
Age	
18-29 years old	25.0
30-49 years old	53.6
50-64 years old	21.4
65 years or older	0

Occupational Status	
Top Management	53.6
Middle Management	46.4
No. of Employees	
0-50	32.1
51-150	28.6
151-300	25.1
301-500	7.1
Over 500	7.1
Annual Turnover (Rs. M)	
Less than 100	11.2
101-500	25.9
501-1000	48.1
Above 1000	14.8
No. of Years in Business	
1-10 years	10.7
11-20 years	21.4
21-30 years	35.7
Over 30 years	32.2
Affiliation	
Local	96.4
Foreign	3.6
Joint Venture	0
Level of Education	
Primary	0
Secondary	0
Diploma	7.1
Undergraduate Degree	25
Postgraduate Degree	67.9

On a scale of 1 to 7 where 1 is 'Not at all' and 7 is 'Very difficult', a mean of 4.33 shows that individual investors were rather neutral on the issue whether it is very difficult or not at all difficult to switch to another stockbroker. This implies that if ever an individual investor is not satisfied with the services of his/her stockbroker, he/she will look elsewhere but if he/she is satisfied then he/she will stay. On the other hand, on the same rating scale, a mean of 4.54 was recorded for institutional investors indicating that it would be rather very difficult for institutional investors to switch to another stockbroker.

Figures in **Table 3** provide a comparison of the factors that make the decision of both individual investors and institutional investors to switch to another stockbroker difficult.

Table 3: Factors that Make the Decision to Switch More Difficult- Mean Comparison Between Individual and Institutional Investors

Factors	Individual Investors	Institutional Investors
	Mean	Mean
Satisfaction with your current stockbroker.	5.78	5.79
Loyalty to your current stockbroker.	5.55	5.71
Lower fees charged by your current stockbroker.	4.89	4.93
Personal relationship with your current stockbroker.	5.12	5.82
Risk/doubt associated with another stockbroker's competence.	4.70	5.50
Unavailability of competent stockbrokers.	5.52	5.07
Time and inconvenience involved in looking for another stockbroker.	4.71	3.64
Embarrassment if friends/ colleagues/ family know that the other stockbroker's service has failed.	3.68	3.21
Long term relationship with current stockbroker.	4.72	5.46
My stockbroker has a sound knowledge of the stock market.	5.07	5.96
Difficulty in forging a new and strong relationship overnight.	4.27	4.86
I won't receive the same service I am receiving now from my current stockbroker elsewhere.	4.91	4.61

On a Likert scale of 1 to 7 where 1 is "Strongly Disagree" and 7 is "Strongly Agree", the main factors that make it difficult for individual investors to switch to another stockbroker were the satisfaction they were experiencing from their current stockbrokers (mean = 5.78), followed by the loyalty factor (mean = 5.55) whereas for institutional investors, it was because their stockbrokers were professionals and had a sound knowledge of the stock market (mean = 5.96) followed by the personal relationship they were sharing with the Company's stockbroker (mean = 5.82).

Indeed, it is worth noting that in financial matters, factors such as embarrassment if friends/colleagues/family know that the other stockbroker's service has failed do not act as switching barriers for both individual investors (mean = 3.68) and institutional investors (mean = 3.21). If there is a need to switch, these investors will go ahead irrespective of what others think.

Results from this study also showed that 66.7% of individual investors had received stockbroking services from one stockbrokerage firm, 30% from two firms and 3.3% from more than two firms during the past five years. As far as institutional investors were concerned, 39.3% had received the same services from two firms during the past five years followed by 32.1% from one firm and 28.6% from more than two firms during the past five years.

H_{1a} was strongly and positively supported by the Chi-Square Tests with an asymptotic significance (2-sided) of less than 5% for Pearson Chi-Square value of 0.037. Moreover, Cramer's V can attain a maximum of 1 and actually the Cramer's V statistic was 0.787 which showed that the relationship was strong. Hence, switching costs and switching barriers are not an obstacle to institutional investors and if need be, they will switch stockbrokers. This is also supported by the study results whereby 39.3% of institutional investors had received stockbroking services from two stockbrokerage firms and 28.6% from more than two firms during the past five years.

With an asymptotic significance (2-sided) of less than 5% for Pearson Chi-Square value of 0.000 and a Cramer's V statistic of 0.753, H_{1b} also was also firmly and confidently supported. Therefore, it can be deduced that switching costs and barriers are an obstacle in the decision of individual investors to switch stockbrokers. This is supported by the study results whereby the majority of individual investors (66.7%) had dealt with only one stockbroker during the past five years.

CONCLUSION

Hence, this survey has shown that individual investors stay much longer with their stockbrokers because they are satisfied with the services they are receiving. A satisfied client is a loyal customer and stays much longer than anyone else. On the other hand, since institutional investors have an obligation towards their company and a responsibility for financial results, they would tend to switch stockbrokers if they are not satisfied with the current services.

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