

# Managing customer loyalty in liberalized residential energy markets: The impact of energy branding

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## Abstract

In numerous recently deregulated energy markets, utilities previously operating in monopolistic environments are now focusing on customer satisfaction and loyalty. In this study, a conceptual framework is proposed that analyses the effects of brand associations and perceived switching costs on customer satisfaction and loyalty in residential energy markets. Several brand associations relevant to energy branding are identified: perceived technical service quality and service process quality, perception of value-added services, environmental and social commitment of the company, brand trust, price perceptions and brand associations related to the corporate attributes “innovative and dynamic”. Subsequently, the proposed model is tested in the scope of a representative survey of Spanish residential energy customers. Results indicate that customer satisfaction, brand trust and perceived switching costs are positively related to customer loyalty and that brand trust exerts a stronger influence on customer loyalty than satisfaction and switching costs. Findings also show significant effects of the perception of service process quality and environmental and social commitment on loyalty via customer satisfaction. Implications for energy brand managers and regulators are discussed.

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## 1. Introduction

The structure of energy markets is undergoing profound changes in many countries of the world. In numerous recently deregulated energy markets, utilities previously operating in monopolistic environments are now exposed to free market competition (Loskow, 1998). In response to this increased competition, energy companies are attempting to better position themselves by becoming more customer-oriented. Consumers may now choose among a range of differentiated products and, like any other consumer service or product, consumers will evaluate product attributes and prices and choose the service most to their liking (Roe et al., 2001). Energy brands with attributes more pleasing to consumers will be able to

charge a premium. Consequently, at present, many energy companies are focusing on branding in an effort to enhance customer satisfaction and, particularly, customer loyalty (Senia, 2002), as costs of new client acquisition in residential energy markets, can be up to 5–6 times higher than costs associated with the retention of existing customers (Nesbit, 2000; Pesce, 2002). There is evidence from empirical studies that improvements in service quality may considerably enhance the prospects of energy companies (Truffer et al., 2001) and that integrating quality of service in regulatory benchmarking is preferable to cost-only approaches (Giannakis et al., 2005). Hence, in first place, most energy providers are trying to improve the perception of the service quality of their energy brands. In addition, many companies aim at augmenting the value perception of their brand by increasing the range of services they currently offer customers (Eakin and Faruqi, 2000; Drummond and Hanna, 2001), or offer “environmentally correct energy” (Kerber, 1997). Particularly,

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green energy products, i.e. electricity offerings, which are based on environmentally preferable energy sources, are gaining importance in energy markets worldwide. They show that customer demand for green energy may be an important driving factor for supporting environmental sustainability in a liberalized market (Truffer et al., 2001).

While there has been some research on both the effect of brand image on customer loyalty in the service industry and the antecedents of customer loyalty in residential energy markets, the role of specific brand associations of residential energy brands is still largely unassessed. However, for the successful positioning of energy brands, brand associations must be identified that are relevant in consumers' eyes. Thus, energy managers need to know which dimensions are relevant for the successful positioning of their brand from a consumer's perspective.

In this study, seemingly relevant brand associations are identified and a conceptual framework is proposed that analyses the effect of brand associations, as well as of customer satisfaction and switching costs on customer loyalty in the residential energy market. The hypothesized model is tested on a representative sample of residential consumers in the Spanish energy market. To assess the relative influence of each identified dimension of brand associations, structural equation modelling was applied to the data collected. Implications for brand managers and regulators in residential energy markets are discussed subsequently.

## 2. Conceptual background and hypothesis

### 2.1. Customer loyalty in residential energy markets

Residential customers can be considered loyal to their energy provider if, in addition to repeatedly purchasing the company's services, they also hold favourable attitudes towards it. This view reflects a popular concept of customer loyalty as repurchase behaviour combined with an attitudinal component (e.g. Bloemer and Kasper, 1995; Zeithaml et al., 1996; Dick and Basu, 1994). While customer loyalty can be treated also exclusively as repurchase behaviour (e.g. Loveman, 1998; Söderlund, 1998), repeated or continuous purchase from the same supplier is not always the result of a psychological commitment towards the company, but may be the result of situational factors such as the lack of availability or provider preference (Dufer and Moulins, 1989), or of factors that act as barriers to change (Liljander and Strandvik, 1995). However, the consumer's disposition in terms of preferences or intentions plays an important role in determining loyalty, e.g. a low sensitivity to price increases, a high resistance to the change of the service provider, preferences for a particular provider, and as recommendations of the company to others (Zeithaml et al., 1996; Parasuraman et al., 1994).

### 2.2. The effect of customer satisfaction on loyalty in residential energy markets

At present, most energy companies aim to enhance customer loyalty by increasing the level of customer satisfaction (Novak, 2002; Thumann, 1998). According to a *cognitive perspective*, customer satisfaction is understood to be the assessment resulting from comparing customer's expectations and their perception of the value of the services received (Oliver and DeSarbo, 1988; Spreng and Olshavsky, 1993; Anderson and Sullivan, 1993). From an *emotional perspective*, satisfaction is considered a positive emotional state resulting from the consumption experience (Bagozzi et al., 1999; Oliver, 1997; Liljander and Strandvik, 1997).

Most service researchers agree on the positive influence of customer satisfaction on the loyalty construct (e.g. Zeithaml et al., 1996; Parasuraman et al., 1988; Johnson and Fornell, 1991; Anderson and Sullivan, 1993; Oliver, 1999). Several studies show a favourable effect of customer satisfaction on customer loyalty in the residential energy market (Powell, 2000; Lloyd, 2000; Johnson, 2001; Antonevich, 2002).

### 2.3. The influence of brand associations on residential energy customer's satisfaction and loyalty

At present, most energy managers are aware of the increasing importance of brand building (Gene, 1995; Greene, 2001; Zolkos, 2002; Senia, 2002; Simmonds, 2002). Brand value is based on strong and unique brand associations related to attributes and benefits of the service and/or corporate values (Keller, 1993; Aaker, 1996). Keller (1998) defines brand associations as informational nodes linked to the brand in memory that contain the meaning of the brand for consumers, i.e. attributes, functional and emotional benefits, as well as brand attitudes. While there has been a tendency to rely on branding models that were developed for product-based brands, in the implementation of service brands factors such as the intangible nature of services and the high variability of perceived service quality must be considered (McDonald et al., 2001). Thus, intangibility and heterogeneity of services make the interpretation of brands as promises toward the customer particularly appropriate in the case of service brands (de Chernatony and Segal-Horn, 2003). Unlike product-based branding, customer facing staff may be as critical to brand perceptions as marketing communications (Bitner et al., 1994). In addition, a focused brand position with a well specified limited number of selected benefits is considered a key factor for successful service branding (de Chernatony and Segal-Horn, 2003).

While numerous brand associations may affect customer satisfaction and loyalty in residential energy markets, we suggest a set of brand associations likely to be particularly relevant in consumers' perception, i.e. associations related to perceived service quality (Dukart, 1998; Umbrell, 2003;

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