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Moderating Effect of Gearing Ratio on the Relationship between Loyalty Programs and Financial Performance of Selected Firms in Service Industry in Kenya

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Abstract

The purpose of the study was to determine the moderating effect of gearing ratio on the relationship between loyalty programs and financial performance of selected firms in service industry in Kenya. The study employed explanatory research design which is non-experimental in nature. The target population was three (3) telecommunication firms (Safaricom, Airtel and Telkom Kenya), 49 supermarkets and 46 Five Star hotels. Since the population of telecommunication firms was small, the study used the census survey method. Purposive sampling was used to select 5 big Supermarkets and 16 Five Star hotels. Panel data analysis was used to link the relationship between the variables. Similarly, One-Way ANOVA was used to find out if the financial performance of the three service industries were different. Diagnostic tests which included normality tests, multicollinearity tests, panel unit root tests and fixed and random effect were carried out. The results further showed that gearing ratio have a negative and significant relationship with financial performance of service industry. The regression results revealed that gearing ratio improved the strength of the relationship between loyalty program and Financial Performance of the Selected Firms in Service Industry in Kenya. Since long term debt provides tax shield for the company, there is every tendency for the company to continue to grow debts, the effect of accumulating unnecessary debts should form regular policy discuss by the management and the directors, hence there should be high-powered committees of the managements and the board to review the debt portfolio from time to time. These committees should be firm on investment/divestment of any

debt capital to ensure that the company stays afloat all the time without the fear of any litigation for not meeting up with all present and previous obligations.

Key words; *Loyalty Programs, Financial Performance, Gearing Ratio & Kenya.*

1.0 Introduction

1.1Background of the Study

Loyalty program is a form of virtual currency which includes bonga points, loyalty points and smart points (Salmon, Dey & Amaro, 2017). Loyalty programs are structured marketing efforts that reward and therefore encourage loyal buying behavior, which is potentially beneficial to the firm (Magatef & Tomalieh, 2015). The reward programs are offered by a company to customers who frequently make purchases. A loyalty program may give a customer advanced access to new products, special sales coupons or free merchandise. Customers typically register their personal information with the company.

According to Peiguss (2012), loyalty programs work as an incentive by providing benefits based on cumulative purchasing over time. Loyalty programs encourage consumers to shift from myopic or single-period decision making to dynamic or multiple-period decision making. These programs encourage repeat buying and improve retention rates by providing incentives for customers to purchase more frequently and in larger volumes (Robert, 2011). Similarly, the author observed that, Loyalty programs are considered part of a comprehensive customer relationship strategy. However, as noted by Kendal (2012), there is a fundamental mistake of many marketers who confuse loyalty with rewards. As such, the author observed that the main objective of Loyalty programs is to offer support and commitment not to earn points.

In support, Magatef and Tomalieh (2015) explained that, organizations normally use reward programs to retain their best customers. In this regard, frequent customers are awarded redeemable points that can be converted into free services, upgrades in class, exchange of other products and services. Further, the authors noted that, Loyalty programs are not only used as a tool to increase the organization's loyal customers, but also as an opportunity to gather information about customer shopping habits and preferences. This information helps in customizing the organization's services. In a similar observation, Kendal (2012) emphasized that, retailers maintain consumers' database so as to identify the best customers and reward them for their preferable behavior. This is due to the fact that, not all customers are potentially loyal customers. As such, the ideal loyalty program would benefit only loyal and potential customers. In conclusion, the author argued that Customer loyalty programs should increase customer happiness and retention.

On the other hand gearing indicates the amount of risk which might exist to the income that would be available to both shareholder and loan holders as well as their capital investment. It is thus a means of raising new funds through extra borrowing. Gearing ratio is an important measure of stability of a company as it is considered when raising external capital. If the company is already highly geared, it might find it extremely difficult to raise additional fund as would-be lender may take a closer look at its structure and believe that the company might not be able to settle the debts as at when due as it is already exposed to so many creditors. The effect of having excess gearing is that such company would have to accumulate higher amount of profit before interest and tax to be able to meet demand for interest payment (Siyanbola, Olaoye & Olurin, 2015). The current study therefore sought to determine the moderating effect of gearing ratio on the relationship

between loyalty programs and financial performance of selected firms in service industry in Kenya.

1.2 Statement of the Problem

A number of studies in relation to loyalty programs have been conducted worldwide. The reviewed studies do not explicitly interrogate the moderating effect of gearing ratio on the relationship between loyalty programs and financial performance of selected firms in service industry in Kenya. For instance, Bwire (2016) conducted a study on the effect of loyalty programs on financial performance of Mobile Tele Communication Firms in Kenya. However, the study focused on the telecommunication firms only. Similarly, there exists a methodological gap since the previous studies used descriptive research design and OLS regression model, whereas the current study used explanatory research design and Random Effect panel regression model. As noted by Baum (2006), OLS regression can have a complicated error process such as heteroscedasticity across panel units and serial correlation within panel units and thus may not give reliable results. The study sought to determine moderating effect of gearing ratio on the relationship between loyalty programs and financial performance of selected firms in service industry in Kenya.

1.3 Objectives of the Study

To determine the moderating effect of gearing ratio on the relationship between loyalty programs and financial performance of selected firms in service industry in Kenya.

2.0 Literature Review

2.1 Theoretical Framework

2.1.1 Customer Loyalty Theory

According to Corbitt, Thanasankit and Yi (2003) the assumption based on which this theory is based is that whenever customers feel satisfied and contented with products and services that the businesses are offering, then they develop trust on the product, service, and the business as well. This is critical in having loyal customers who make repeat sales considering that their needs and expectations are being met. In the long run, this will build a strong business reputation and increase business sales that significantly contribute to increased profitability in business.

Russell and Julie (1986) claimed that, customer loyalty marketing programs can be manifested in various forms, with shoppers' reward cards being the commonly used by businesses. Customers that opt for loyalty programs are mostly motivated by the need to save while shopping and the unique recognition provided by these programs. Loyalty marketing programs utilize gifts, special offers, rewards, cash back or points to persuade consumers to purchase goods and services and eventually become unique customers (Carman, 1990). Other can be more sophisticated, with branded swipe card that track purchases or with identification number of customers. In other instances, the marketer gives deals limited to members only, an approach which encourages customers to register for the programs.

Coulter and Coulter (2003) did a study on the influence of loyalty program on profitability of the firm whose findings revealed that those firms that implemented loyalty programs recorded higher sales than firms that did not use loyalty program. This was as a result of increased sales especially from consistent customers which led to improved profitability. It was concluded that customer loyalty has a positive correlation with profitability of the firm.

Advocates of this theory Cronin and Taylor (1992) and Cronin, Brandy and Hult (2000) claim that, loyalty marketing is a long-term approach developed to keep customer attached to the business. Some marketers create brand images for products that enable customers relate feelings of innovation the product. Other instances, a product is marketed on bases of its utility and features. In these instances, the customer makes decision based on value of the product as opposed to price savings and knowledge of loyalty program.

2.2 Literature Review

Kamau (2017) conducted a study on the effect of loyalty programs on customer retention: A Case of Nakumatt Supermarkets Kenya. The study used four variables which included: point system, smart cards, gift vouchers and discounts on customer retention in Nakumatt supermarket. The study adopted descriptive survey research design. Using the design, both quantitative and qualitative data was collected. The study concludes that there is a positive significant relationship between Loyalty point systems and customer retention. The findings also conclude that there is a positive significant relationship between smart cards and customer retention. Further the study concludes that there is a positive significant relationship between gift vouchers and customer retention. Finally, the study concludes that there is a positive significant relationship between gift vouchers and customer retention. The study recommends application of point system in all the stores since it was noted as one of the reasons that customers make repeat purchases from the supermarket. The points accumulated by the customers should be redeemed quite often in order to encourage and motivate loyal customers. The study further recognizes the use of smart cards thus recommending retail stores to increase the use of smart cards especially for middle- and high-income earners in Kenya. Kamau (2017) study is similar to Scott (2009) study which studied effects of loyalty programs and customers retention in telecommunications industry in German service firms. The study used a cross-sectional study to establish the relationship between customer loyalty programs and customers retention. Data was collected using structured questionnaires. The study used a sample of 50 respondents and data was analyzed with the help of a regression equation. The author found out that customer retention was positively related to loyalty programs.

Siyanbola, Olaoye and Olurin (2015) conducted a study of the impact of gearing ratio on financial performance of companies in Nigeria. The author used operating leverage; financial leverage and combined leverage as the independent variables. A survey research design was adopted in which twenty workers of selected manufacturing companies were used. The study was based on information gathered from both primary and secondary data. The study also found out that, gearing has direct relationship with the financial performance of a company. Based on the findings and the fact that gearing provides some financial advantages with positive impact on profitability, the author recommended that companies should employ competent professionals to take charge of monitoring all long-term financing that the company utilize. Such officer should be mindful of the risk involved in various source of finance.

Lee (2008) studied the influence of ownership structure on firm financial performance in South Korea. The author focused on ownership concentration which is shared by majority shareholders and identity of owners which is foreign investors and institutional investors. The study used panel regression model with data from 2000-2006. The author found out that firm performance measured by the rate of return on assets improved as ownership concentration increased. The influence of foreign ownership and institutional ownership were insignificant. The study concluded that as ownership concentration increased, the positive monitoring influence of concentrated ownership

first dominated but later was outweighed by the negative influences such as the appropriation of minority shareholders. These findings serve as an insight to policy makers in emerging economies on ownership structure and performance.

Nirosha and Staurt (2014) conducted a study on ownership structure and firm financial performance in Sri Lanka. The study investigated the influences of equity ownership structure on ROA of Sri Lankan listed businesses. Using dynamic panel generalized method of moment the study found an inverse hump shape relationship between insider ownership and firm financial performance. The results of this study confirmed that the influence of insider ownership on firm performance was positive and significant where legal protection for investors is weak. The results further suggested that although new legislative reforms had been enacted, Sri Lankan companies were highly dependent on internal governance mechanisms.

Ebaid (2009) studied the influence of ownership structure on financial performance with evidence from Scandinavia. Ownership concentration, voting right of block holder and owner identity were the independent variables whereas financial performance was the dependent variable. Firm performance is represented by valuation, growth, profitability and risk. Twelve hypotheses were tested using regression analysis model. The results indicated that ownership concentration has a positive influence on firm profitability and growth, and a negative influence on firm valuation and risk. Similarly, divergence between voting right and capital right has positive influence on firm valuation. The study also found out that owner's identities do influence firm performance, especially with regard to profitability and growth.

2.3 Conceptual Framework

The conceptual framework is as shown in Figure 1.

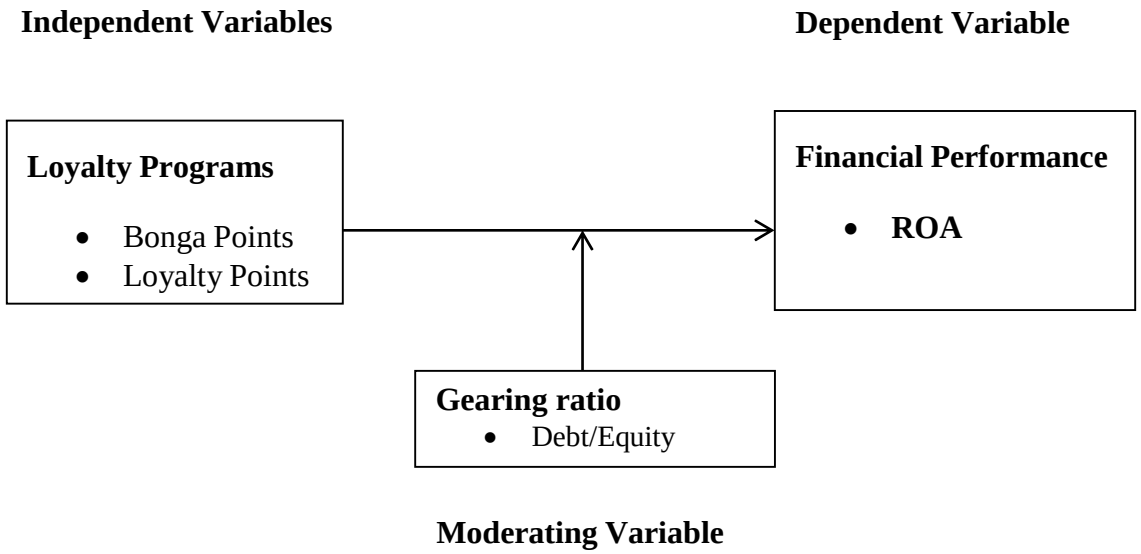

Figure 1: Conceptual Framework

3.0 Research Methodology

The study employed explanatory research design which is non-experimental in nature to analyze financial performance of selected service industry firms and the role of loyalty programs. An explanatory research design is appropriate where the researcher is attempting to explain how the phenomenon operates by identifying the underlying factors that produce change in it (Kerlinger & Lee, 2000). The target population was three (3) telecommunication firms (Safaricom, Airtel and Telkom Kenya), 49 supermarkets (Attached in appendix II) and 46 Five Star hotels. Since the population of telecommunication firm is small the study used the census survey method. Therefore, the study used the three (3) telecommunication firms (Safaricom, Airtel and Telkom Kenya). Purposive sampling was used to select the 5 big supermarkets that were offering their clients smart points namely: Tuskys Supermarket, Naivas Supermarket, Nakumatt Supermarket, Ukwala Supermarket and Uchumi Supermarket and all the 16 five-star hotels in Nairobi offering loyalty points namely Nairobi Safari Club, Serena, Ole Sereni, Panari Hotel, Sarova Stanley Hotel, Safari Park Hotel, Southern Sun Mayfair Nairobi, The Fairmont Norfolk Hotel, The Giraffe Manor, Windsor Golf Hotel, Country Club, Hilton Hotel, Sankara and Laico Regency, Intercontinental and Villa Rosa Kempinski. Purposive sampling technique of selecting the 5 supermarkets and 16 hotels was suitable because of the availability of the data. The others were dropped since their data was neither published in the financial statements nor in their websites. The 5 supermarkets and 16 hotels represent 10% and 21% of the sample size respectively. This is also supported by Kothari (2013) who explains that, 10% or more of a sample is adequate for a study. Therefore, using 5 supermarkets and 16 hotels were adequate for the study. Panel data analysis was used to link the relationship between the variables. Similarly, One-Way ANOVA was used to find out if the financial performance of the three service industries were different.

The model in the equation below indicates the panel data model.

$$Y_{it}=\beta_0+ \beta_1X_{1it} + \beta_2X_{2it}+ \beta_3X_{1*}X_{2it} + e \quad \text{.....1.0}$$

Where;

Y_{it}= ROA

X_{1it}= Loyalty Programs

$X2_{it}$= Gearing Ratio

4.0 Results and Discussion

4.1 Descriptive Statistics

This section provides descriptive results for the variables. Descriptive statistics employed were mean, minimum, maximum and standard deviation. The results are presented in Table 1.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev	Min	Max
ROA	168	0.2138095	0.2919269	0.09900	0.37900
Loyalty Programs	168	1539548	5585112	1515969	2229289
Gearing ratio	168	3.636429	1.047213	3.00600	4.60700

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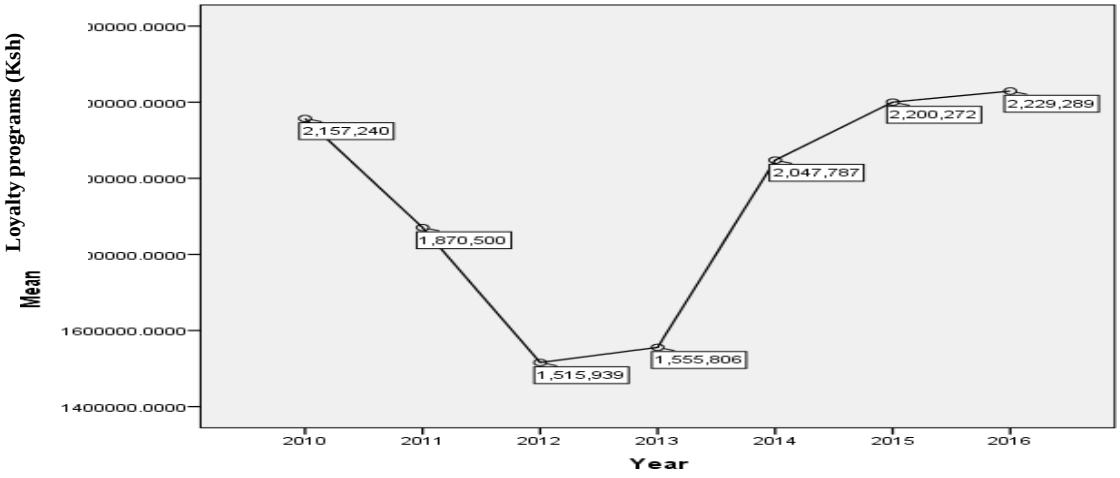
The results show that the average mean of ROA was 21.38095% which indicate the average of 21.38095% of the selected companies from the year 2010 to 2016. The minimum and the maximum of ROA between the year 2010 and 2016 were 9.900% and 37.900% respectively. Its standard deviation was 29.19269% which indicated that ROA varied throughout the measurement period. Further, results showed that the average mean of loyalty program was Ksh1, 539,548 million. The minimum and the maximum of loyalty program between the year 2010 and 2016 were Ksh1, 515,969 million and Ksh2, 229,289 million respectively. Its standard deviation was Ksh5, 585,112 million which indicated that program varied throughout the measurement period.

The average mean of gearing ratio was Ksh3.636429. The minimum and the maximum of gearing ratio between the year 2010 and 2016 were Ksh3.00600 and Ksh4.607 respectively. Its standard deviation was Ksh1.047213which indicated that gearing ratio varied throughout the measurement period.

4.2 Trend Analysis

4.2.1 Loyalty Programs

Figure 2 presents results of trend analysis for Loyalty programs. The results show that the value of loyalty programs for the service industry was Ksh2, 157,240 in the year 2010. However, this value declined to Ksh1, 870,500 in the year 2011 and further declined to Ksh1, 515,939 in the year 2012. This trend might have been caused by the pre-election tension and campaign mood for 2013 general election which made investors and individuals to withhold their cash. The results further show that the value of loyalty programs for the service industry rose to Ksh1,555,806 in the year 2013 and further rose to Ksh2,047,787 in the year 2014. This could have been caused by the peaceful elections of 2013 and thus indicating gain of confidence and willingness to transact business among the consumers. The value of loyalty programs further rose to Ksh2,200,272 in the year 2015 and then further to Ksh2,229,289 in the year 2016.This shows that loyalty programs have really been gaining popularity among the service providers customers.

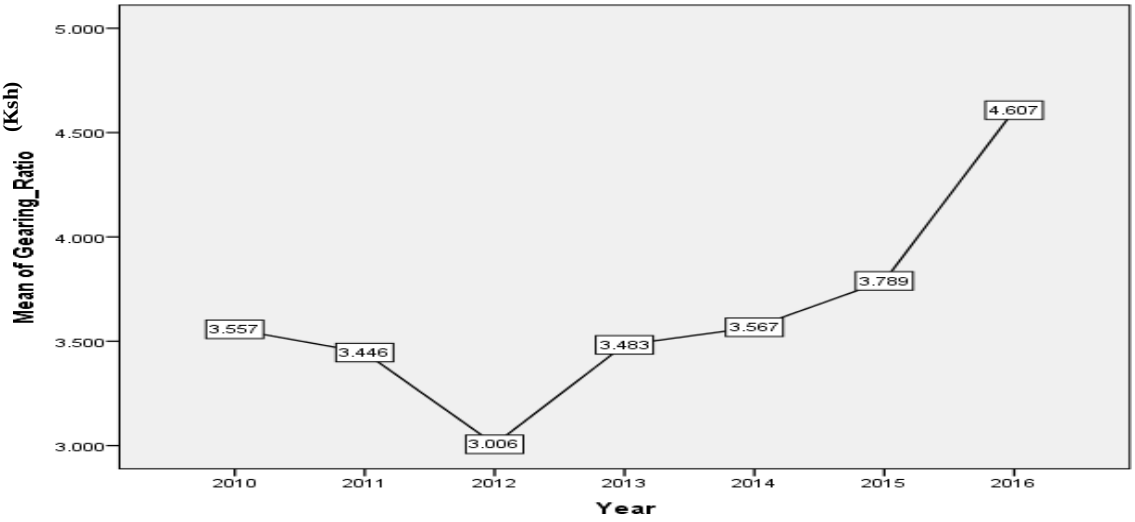


Source: Author (2018)

Figure 2: Trend Analysis for Loyalty Programs for the Period 2010-2016

4.2.2 Trend Analysis for Gearing Ratio for the Period 2010-2016

Figure 3 presents results of trend analysis for gearing ratio. The results show that the value for the gearing ratio for the service industry was Ksh3.557 in the year 2010. However, the gearing ratio declined to 3.446 in the year 2011 and further declined to Ksh3.006 in the year 2012.This could have been caused by fear by financial institution to lead money before the 2013 general election due to uncertainties of the stability of the government. The results further showed that the gearing ratio rose to Kes3.483 in the year 2013 and further rose to 3.567 in the year 2014. The gearing ratio further rose to Ksh3.789 in the year 2015 and further rose to Ksh4.607 in the year 2016 which may be due to regain of confidence after the successful general election of 2013. This implies that the gearing ratio of the service industries have been increasing over the past few years.



Source: Author (2018)

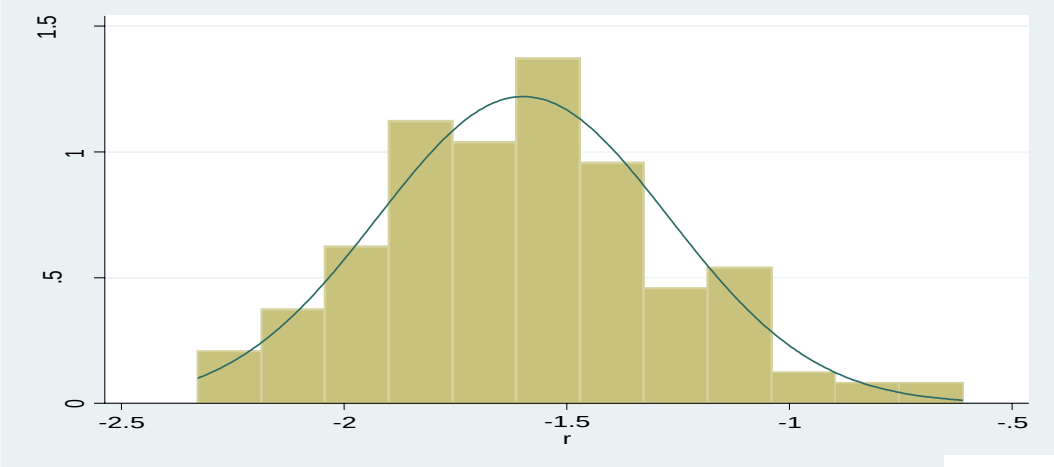
Figure 3: Trend Analysis for Gearing Ratio for the Period 2010-2016

4.3 Diagnostic Test

Diagnostic tests for this study were conducted. This included; normality test, multicollinearity test, heteroskedasticity test and autocorrelation.

4.3.1 Normality Test

The test for normality for the dependent variable (ROA) was examined using the graphical method approach as shown in the Figure 4. The results indicate that the residuals are normally distributed.



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Residual Mean score

Source: Author (2018)

Figure 4: Normality Test for Financial Performance

4.3.2 Multicollinearity Test

Multicollinearity was assessed in this study using the variance inflation factors (VIF). According to Field (2009), VIF values in excess of 10 are an indication of the presence of multicollinearity. The results in Table 2 present variance inflation factors results and were established to be 1.04 which is less than 10 which according to Field (2009), it indicates that there is no multicollinearity.

Table 2: Multicollinearity Results Using VIF

Variable	VIF	1/VIF
Gearing ratio	1.06	0.944184
Loyalty programs	1.03	0.973404
Mean	1.04	

Source: Author (2018)

4.3.3 Heteroskedasticity Test

The error process may be Homoskedastic within cross-sectional units, but its variance may differ across units, a condition known as group wise Heteroskedasticity. The panel data command calculates Breuch- Pagan for group wise Heteroskedasticity in the residuals. The null hypothesis specifies that H0: sigma (i)^2 = sigma^2 for all i. The results in Table 3 indicate that the null hypothesis of Homoskedastic error terms is not rejected as supported by a p-value of 0.0702.

Table 3: Heteroskedasticity Test

Breusch-Pagan test for group wise heteroskedasticity in fixed effect regression model
H0: sigma(i)^2 = sigma^2 for all i
chi2 (24) = 11436.52
Prob>chi2 = **0.0702**

Source: Author (2018)

4.3.4 Panel Unit Root Test (Stationarity Test)

Most economic variables are usually non-stationary in nature and prior to running a regression analysis. Unit root tests were thus conducted using the Levin Lin Chu (LLC) test to establish whether the variables were stationary or non-stationary. The purpose of this is to avoid spurious regression results being obtained by using non-stationary series. Results in Table 4 indicated that all variables are stationary (i.e. absence of unit roots) at 5% level of significance.

Table 4: Unit Root Results

Variable name	**Statistic ADF Value**	**P-value**	**Comment**
Loyalty programs	-5.35179	0.0000	Stationary
Gearing Ratio	-3.72972	0.0001	Stationary
ROA	-11.6787	0.000	Stationary

Source: Author (2018)

4.3.5 Fixed and Random Effects (Hausman test)

Table 5 presents the results for Hausman test. A resultant p-value of 0.330 was large than the conventional p value of 0.05 and thus not rejecting the null hypothesis that the random effect is appropriate and thus the random effects model was more appropriate.

Table 5: Hausman Results

	(b) Fixed	**(B) Random**	**(b-B) Difference**	**Sqrt (diag(V_b-V_B)) S.E.**
Loyalty programs	6.56E-09	8.54E-09	-1.98E-09	3.16E-09
Gearing ratio	0.035033	0.033466	0.001568	0.003886
chi2(2) =2.10				
Prob>chi2 =0.330				

Source: Author (2018)

4.6 Regression Analysis

A multiple regression model was estimated to establish the joint effect of all the independent variables on the dependent variable. Results are presented in Table 6.

Table 6: Overall Regression Analysis Model

ROA	Coef.	Std. Err	T	P>|t|
Loyalty Program	0.854	0.489	2.04	0.001
Loyalty Program *Gearing Ratio	-0.655	-0.821	2.84	0.006
_cons	0.3781	0.0887923	0.13	0.898
R Squared = 0.564				
F-statistic = 18.45				
p-value = 0.032				

Source: Author (2018)

Thus, the specific regression model was modeled as:

ROA = 0.3781 + 0.854LP - 0.655(LP × GR)

The results in Table 6 show that loyalty program has a positive and statistically significant relationship with financial performance (r = 0.854, p = 0.001). The results further showed that the interaction term between loyalty programs and gearing ratio have a negative and significant relationship with financial performance (r = -0.655, p = 0.006).This could be due to the fact that, as firm gearing ratio increases, the risk also increases and also high cost of paying interest emanating from high gearing.

The results indicate that the overall model was statistically significant. Further, the results implied that the independent variable is a good predictor of financial performance of the service industries. This was supported by an F calculated which was 18.45 and greater than the F critical value which was 3.94. The null hypothesis was that there is no significant relationship between loyalty programs and performance of service industry in Kenya. Results in Table 6 above show that the p-value was 0.035 $p<0.05$ suggesting a statistically significant relationship between loyalty programs and financial performance of service industry in Kenya.

This regression equation model implied that for every additional number of loyalty programs the company financial performance (ROA) increased by 56.4%. In additional, with increase in gearing ratio, the company financial performance decreases by 56.4%; holding all the other factors constant.

6.0 CONCLUSIONS

Based on the research findings the study concluded that loyalty programs have a positive and significant effect on Financial Performance of the Selected Firms in Service Industry in Kenya. The study also concluded that gearing ratio moderates the relationship between loyalty programs and financial performance of the selected firms in service industry in Kenya.

6.0 Recommendations

Since long term debt provides tax shield for the company, there is every tendency for the company to continue to grow debts, the effect of accumulating unnecessary debts should form regular policy discuss by the management and the directors, hence there should be high-powered committees of

the managements and the board to review the debt portfolio from time to time. These committees should be firm on investment/divestment of any debt capital to ensure that the company stays afloat all the time without the fear of any litigation for not meeting up with all present and previous obligations. In addition, excessive debt capital n the telecommunication company should be immediately repaid or deplored to earning assets.

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