

# THE IMPACT OF SERVICE QUALITY ON MALAYSIAN MUSLIM ISLAMIC BANK CUSTOMERS: SATISFACTION, LOYALTY AND RETENTION

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## Abstract

*With increasing competition in terms of better services and recent specific requirements for shari'ah compliance, the Islamic banking sector is not only expected to provide a higher standard of quality service, but also to be Shari'ah compliant. Hence it is timely to examine the impact of service quality on customer satisfaction as well as customer loyalty and retention in Islamic banks in Malaysia with the increase emphasis of shariah governance and compliance in the banking industry.*

*A purposive sample of 339 Islamic bank customers with Islamic bank accounts was selected for the purpose of this study. Due to the institutional impediments in direct distribution of survey questionnaires, an online survey to selected respondents was administered. The survey sample includes respondents who are customers with banking accounts of several prominent Islamic banks in Malaysia.*

*The service quality dimensions examined are tangibility, reliability, empathy and responsiveness and analysis of the significant effects of these dimensions on customer satisfaction, customer loyalty and customer retention. Among all these, except tangibility dimension, show significant impact on customer satisfaction and higher impact on customer loyalty and customer retention. In addition, this is an attempt to analyze the impact of service quality on customer satisfaction, customer loyalty and customer retention. This implies that customer utility experience is expected to result in a longer term relationship with Islamic banks.*

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*The findings of this research conclude the significance of service quality as well as its positive significant influence on customer satisfaction as well as higher impact on customer loyalty and customer retention. Hence the study contributes to the further development of studies on service quality, customer satisfaction with loyalty and retention. The social change implication for this research is to increase customer satisfaction and improve services in Malaysian Islamic banks.*

**Keywords:** Islamic bank, service quality, customer satisfaction, customer loyalty, customer retention

## INTRODUCTION

The Islamic banking system has gained momentum globally. Presently, there are about 180 Islamic banks and finance institutions in Asia, Africa, Europe and the USA with more than 8,000 branches with about US\$170 billion. Estimates suggest that global Islamic financial services increased at a rate of 10%-15% over the period from 1995 to 2005. Islamic Financial Services Industry (IFSI) assets were worth US\$700 billion in 2005 and grew at an annual growth of 15% until 2010, it is expected that IFSI can grow to US\$1.4 trillion by 2010 and to US\$2.8 trillion by 2015.<sup>2</sup> Islamic banking industry is not only limited to the Islamic banks as more and more global banks are showing interest in the Islamic banking system at the same time.<sup>3</sup>

With the growing importance of the service sector, it is vital for companies to differentiate themselves from competitors by continuously delivering high quality services.<sup>4</sup> By the end of the 20th century, companies found that by focusing only on the

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<sup>2</sup> Hosseini Estiri, & Yazdani, "Determinants of Customer Satisfaction in Islamic Banking: Evidence from Iran," (2011), 300.

<sup>3</sup> K. Naser, A. Jamal & K. Al-Khatib, "Islamic Banking: A Study of Customer Satisfaction and Preferences in Jordan." *International Journal of Marketing*, 17(3), (1999), 140.

<sup>4</sup> J. Heskett, "Lessons in the Service Sector." *Harvard Business Review*, 65 (2), (1987), 123; J. L. Heskett, W. E. Jr., & C. W. Hart, *Service Breakthroughs: Changing the Rules of the Game*. (New York: The Free Press, 1990).

enhancement of service quality, it cannot guarantee profitability and deal with domestic as well as international competition. While customer satisfaction is based on good service quality, satisfied customers may not stay with the exact same service provider for their lifetime as a result of some other uncontrollable factors resulting in loss in profits.<sup>5</sup> Together with such findings, the focus of marketers in addition to academic researchers has slowly shifted from concentrating on improving operational performance to raised order constructs, such as customer loyalty and customer retention, which are considered to contribute to companies' long-term achievement.<sup>6</sup>

The increase emphasis of customer loyalty and retention towards a more sustainable strategy for Islamic banks is addressed by extending the service quality customer satisfaction model to customer loyalty and customer retention. This study specifically examines the dimensions of service quality and their effects on customer satisfaction, customer loyalty and customer retention.

## LITERATURE REVIEW

### Service Quality

As a general rule developed economies businesses are service-oriented rather than goods-oriented, service quality requires a notable place in the marketing-management literature. Service quality is often defined as the customer's impression of the actual relative inferiority/superiority of the service provider and its services<sup>7</sup> and it is often considered similar for the customer's overall attitude towards a company.<sup>8</sup> Researchers have attempted to conceptualize and also measure service quality as well as clarify its relation towards the

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<sup>5</sup> F. F. Reichheld, "Loyalty-based Management." *Harvard Business Review*, 71 (2), (1993), 70.

<sup>6</sup> Reichheld, "The Loyalty Effect: The Hidden Force Behind Growth, Profit, and Lasting Value," (1996), 211.

<sup>7</sup> Rust & Oliver, "Service Quality – New Directions in Theory and Practice," (1994), 80.

<sup>8</sup> V. Zeithaml, L. L. Berry & A. Parasuraman, "Communication and Control Processes in the Delivery of Service Quality." *Journal of Marketing*, 52 (2), (1998); M. J. Bitner, "Evaluating Service Encounters: The Effects of Physical Surroundings and Employee Responses." *Journal of Marketing*, 54 (2), (1990).

overall performance of companies and organizations.

The study on service quality considers the fact that services are intangible, heterogeneous, and their “production” and “consumption” tend to be generally inseparable, the process utilized by customers to assess service quality is remarkably complex and cannot be easily identified. The ideas of services are considered both by means of the outcome as well as the production and delivery process. Gronroos considers services as products needing, with a large extent, the consumer’s involvement in the whole process of production and also consumption; when consumers compare their expectations concerning the service using what they in reality receive. Hence service quality is the consequence of perceived service quality.<sup>9</sup>

### ***Service Quality Dimensions***

Gronroos and Parasuraman et al, advances the study on service quality with the SERVQUAL model which is based on the *disconfirmation paradigm* where SERVQUAL is obviously a comparison between consumers’ expectations and their perceptions of the service they received to assess cognitive customer dissonance.<sup>10</sup> Together with the *disconfirmation paradigm* towards the measurement of SERVQUAL, Gronroos designed The Nordic Model. He recognized two dimensions. The first dimension was technical quality which described the outcome on the service performance or even what the customer received from the service experience. The other dimension was functional quality that was the subjective perception of how the service had been delivered.<sup>11</sup>

An original SERVQUAL instrument determined ten components of service quality. Additional study was carried out by Parasuraman et al. In the most frequently used version, service quality can be calculated as the gap between customer expectations

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<sup>9</sup> C. Gronroos, *Strategic Management and Marketing in the Service Sector*. (Finland: Swedish: School of Economics and Business Administration, 1982)

<sup>10</sup> L. Festinger, *A Theory of Cognitive Dissonance*, (Stanford CA: Stanford University Press, 1957) accessed <http://simplypsychology.org/cognitive-dissonance.html>.

<sup>11</sup> Gronroos. “A Service Quality Model and its Marketing Implications.” *European Journal of Marketing*, Vol. 18 No. 4, (1984), 40.

and perceptions.<sup>12</sup> The 22 items on this instrument are categorized directly into five dimensions: *reliability*, that is, the ability to do the service within an accurate and dependable way; *tangibles* that refers for the appearance of physical factors, for example, equipment, facilities and personnel; *empathy* that involves providing individual attention and also care to customers; *responsiveness* that is the willingness to supply help with prompt service to customers; and assurance which refers to the knowledge and *courtesy* involving employees and their capability to convey trust and responsiveness/assurance. Five items are utilized to measure each dimension and the instrument is administered double in various forms so that both customer expectations and perceptions can be measured individually. Reliability analysis for the instrument demonstrated an alpha coefficient scale ranging from 0.87 to 0.90 along the different service sectors that were analyzed. By rephrasing the items measuring expectations, the instrument was further refined by Parasuraman et al.<sup>13</sup>

The fundamental assumption underlying the SERVQUAL scale is the fact that below expectation (receiving a negative score) creates a perception of low service quality, while exceeding expectation (receiving a positive score) creates a perception of high service quality. Consequently, perceived service quality would be the result of the customer's evaluation of expected service with the service received.

They recognized the variations between customers' expectations and perceptions using three probable scenarios to define exactly how service quality is perceived by customers:

1. Expectations of service quality tend to be realized (quality exceeds expectations)  $PS > EX$  or  $PS - EX > 0$
2. Expectations of service quality are generally met (quality is acceptable)  $PS = EX$  or  $PS - EX = 0$

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<sup>12</sup> A. Parasurman, L. Berry & V. Zeithmal, "Servqual: A Multi-item Scale for Measuring Consumer Perceptions of SQ." *Journal of Retailing* 64 (2), (1988), 25.

<sup>13</sup> A. Parasuraman, L. Berry, V. Zeithmal, "Perceived Service Quality as a Customer Based Performance Measure: An Empirical Examination of Organizational Barriers Using an Extended Service Quality Model." *Human Resource Management*, (1991), 350.