

THE IMPACT OF SERVICE QUALITY ON CUSTOMER  
SATISFACTION AND CUSTOMER LOYALTY:  
AN EMPIRICAL STUDY ON ISLAMIC BANKS  
IN BAHRAIN

*Saad Mateen Ahmed*  
*Khaliq Ahmad<sup>1</sup>*  
*Muhammad Tahir Jan*

**Abstract**

*The quality of service plays a vital role in any service-related economic sector, including in the banking services industry. While the service sector is a major contributor to economic activity, in-depth study on service quality and its impact on customer satisfaction have been largely overlooked. Moreover, all organizations seek quality, particularly those in the service sector, and this holds true in the banking sector. The role of service quality in the survival and success of Bahraini banks have failed to acknowledge its significant impact on the industry's competitiveness. In service organizations, enhancing service quality is now considered as the most important step in gaining a competitive edge in the market.*

*Bahraini Islamic banking services quality is the focus of this study. To measure Islamic banks services quality, as perceived by market followed by customer satisfaction and loyalty, eventual increased market share and increase in potential customers, enhanced productivity, increased profitability in Islamic banking business in Bahrain, are inevitable. Hence the objectives for this study would be to examine the impact of service quality on customer satisfaction and customer loyalty.*

*The present research is expected to acknowledge achievement of customer satisfaction and customer loyalty through the*

---

<sup>1</sup> Corresponding author.

*measurement of service quality and to provide recommendations in developing an effective Islamic banking service quality. Therefore, any research effort undertaken to enhance the service quality of the Islamic Banks in Bahrain should be considered as an important attempt to significantly contribute and support the Islamic banking institution. This study will also provide practitioners innovative ideas for refining quality of services with the purpose of achieving a competitive advantage in the Islamic Retail Banking sector in Bahrain.*

**Keywords:** service quality, customer satisfaction, customer loyalty, Islamic banking and finance in Bahrain, SERVPERF

## **Introduction**

The banking services environment, around the world, has been considerably altered by technological, regulatory and structural factors in the final two decades of the twentieth century.<sup>2</sup> In an increasingly competitive environment, service quality, as a vital measure of a company's performance, keeps on compelling the consideration of banking organizations, and stays in the limelight of service marketing writings.<sup>3</sup> It was observed by many researchers that the importance given to service quality is mainly due to demand of greater service quality which eventually led to higher customer satisfaction and loyalty, higher readiness to propose to others, decrease in objections and complaints, and enhanced retention rate of customers.<sup>4</sup> In the background of banking services, Almosawi

---

<sup>2</sup> M. G. Angur, R. Nataraajan, & J. S. Jahera Jr, "Service Quality in the Banking Industry: An Assessment in a Developing Economy." *International Journal of Bank Marketing*, 17 (3), (1999), 117.

<sup>3</sup> U. Yavas, & M. M. Yasin, "Enhancing Organizational Performance in Banks: A Systematic Approach." *Journal of Services Marketing*, 15 (6), (2001), 446.

<sup>4</sup> P. J. Danaher, "Using Conjoint Analysis to Determine the Relative Importance of Service Attributes Measured in Customer Satisfaction Surveys." *Journal of Retailing*, 73 (2), (1997); A. Magi, & C. R. Julander, "Perceived Service Quality and Customer Satisfaction in a Store Performance Framework." *Journal of Retailing and Consumer Services*, 1, (1996); T. Levesque & G. H. G. McDougall, "Determinants of Customer Satisfaction in Retail Banking." *International Journal of Bank*

mentioned that service quality is primarily important as it offers a greater level of customer satisfaction, and it, therefore, turned out to be a vital competitive advantage.<sup>5</sup>

The global economic recession and unrest in financial markets has greatly damaged the confidence of banking and finance sector consumers all over the world. Banking industry has become greatly competitive in the existing business setting. Banks are greatly realizing the need to single out themselves from the competitors, on various criteria which can boost customer satisfaction and loyalty, since banks are offering approximately homogenous products to the customers. The result has shown paramount importance of customer satisfaction and loyalty for the enhanced performance of an organization in the long run.<sup>6</sup> With the aim of enhancing confidence of customers in the abilities of service providers, customer satisfaction and loyalty are the vital factors deliberated in the current literature.<sup>7</sup>

The most outstanding economic and financial development of the twentieth century is the development of an alternative banking system, the Islamic banking system, in the Muslim world.<sup>8</sup> Islamic banking can be termed as banking activities that are in line with principles of the *shariah* (Islamic law) and led by Islamic economic theories and practices.<sup>9</sup> A rapid growth has been witnessed by the

---

*Marketing*, 14 (7), (1996), 15.

<sup>5</sup> M. Almosawi, "Bank Selection Criteria Employed by College Students in Bahrain: An Empirical Analysis." *International Journal of Bank Marketing*, 19 (3): (2001), 117.

<sup>6</sup> R. Hallowell, "The Relationships of Customer Satisfaction, customer Loyalty, and Profitability: An Empirical Study." *International Journal of Service Industry Management*, 7 (4), (1996).

<sup>7</sup> A. S. Dick, & K. Basu, "Customer Loyalty: Toward an Integrated Conceptual Framework. *Journal of the Academy of Marketing Science*, 22 (2), (1994); T. J. Gerpott, W. Rams, & A. Schindler, "Customer Retention, Loyalty, and Satisfaction in the German Mobile Cellular Telecommunications Market." *Telecommunications Policy*, 25 (4), (2001).

<sup>8</sup> M. Daud, I. M. Yussof, & A. Abideen, "The Establishment and Operation of Islamic Banks in Nigeria: Perception Study on the Role of the Central Bank of Nigeria." *Australian Journal of Business and Management Research*, 1 (2), (2011).

<sup>9</sup> H. Nasib, "Islamic Finance—A Global Proposition." *Capco Institute Bulletin*, 26. (2008).

Islamic banking and finance industry in the global financial markets with an annual growth rate of about 15%.<sup>10</sup> Assets of Islamic financial institutions have grown by an average of 19% per annum over the past four years to reach over \$1.3 trillion in 2011, suggesting a healthy demand for *shariah*-compliant investing. Globally, Islamic banking assets are expected to grow to \$3.4 trillion by 2018.<sup>11</sup>

The rapid growth of the Islamic finance industry has resulted in an intense competition among the industry-players, not just the Islamic banks, but also the conventional banks. Owing to rapid globalization, the competition between conventional and Islamic banks is most likely to increase in the future. The global market, as a result of liberalization, is quickly congregating into a single market place. It is essential for the Islamic banks to enhance the service quality and offer innovative products with the intention of benefiting from the opportunities provided by the dynamics of globalization. Therefore, an Islamic bank must develop a marketing strategy to achieve competitive advantage and create a solid competitive position based on quality of service.

Bahrain has a long history in the Islamic banking and finance industry. The first Islamic commercial bank in the kingdom, Bahrain Islamic Bank (BIB), was established in 1979. As stated by Wilson, Bahrain is remarkably regarded as a highly advanced country in respect to its Islamic finance system within the Gulf Cooperation Council (GCC).<sup>12</sup> Bahrain's *shariah*-compliant financial sector is one of the earliest and most well established internationally. Astonishingly, it has developing at a record pace in the last few years, the Islamic banking segment has grown at a greater pace than the conventional segment. An increasing desire of customers who want to transact according to *shariah* laws has been witnessed by the Islamic Banking industry in Bahrain.

---

<sup>10</sup> B. S. Chong, & M. H. Liu, "Islamic Banking: Interest-free or Interest-based?" *Pacific-Basin Finance Journal*, 17 (1), (2009), 126.

<sup>11</sup> Ibid.

<sup>12</sup> R. Wilson, "Why Islamic Banking is Successful? Islamic Banks are Unscathed Despite Financial Crisis." Accessed 2009, [http://www.isdbforum.org/Subjects/Islam\\_and\\_the\\_Financial\\_Crisis/rwilson.pdf](http://www.isdbforum.org/Subjects/Islam_and_the_Financial_Crisis/rwilson.pdf)

According to the Central Bank of Bahrain, there are six (6) Islamic retail banks and eighteen (18) Islamic wholesale banks functioning in Bahrain.<sup>13</sup> Bahrain, leading the Islamic Banking industry in the GCC region, has developed as a natural and suitable place in the Middle East region as an Islamic Finance hub. The Islamic banking system, especially in Bahrain and GCC region in general, is noticing the admittance of new players and strategic alliances among the current players. Thus, the banking sector has remained a key factor in the economy of Bahrain.

The purpose of this study is to examine the impact of service quality on customer satisfaction of and customer loyalty for Islamic banks of Bahrain. The specific objectives are: 1) to examine the impact of service quality on customer satisfaction; 2) to examine the impact of customer satisfaction on customer loyalty; 3) to examine the impact of service quality on customer loyalty.

The main research questions for this study therefore would be to address the above objectives, and these are: 1) What is the impact of service quality on customer satisfaction? 2) What is the impact of customer satisfaction on customer loyalty? 3) What is the impact of service quality on customer loyalty?

## **Literature Review**

This section will discuss in detail the key dimensions of this study, which includes service quality, customer satisfaction and customer loyalty, and then lead the discussion of the development of the hypotheses.

### ***Service Quality***

Parasuraman et al. defined service quality as a result of the comparison that customers make between their expectations about a service and their perception of the way the service has been performed.<sup>14</sup> Service quality, owing to liberalization and

---

<sup>13</sup> CBB. "Central Bank of Bahrain", (2015).

<sup>14</sup> A. Parasuraman, V. A. Zeithaml, & L. L. Berry, "A Conceptual Model of Service Quality and its Implications for Future Research." *Journal of Marketing*, 49 (4), (1985), 43.