



**AN EXAMINATION OF THE RELATIONSHIP  
AMONGST SERVICE QUALITY DIMENSIONS,  
CUSTOMER SATISFACTION, AND LOYALTY  
TOWARDS ISLAMIC BANKS IN MALAYSIA**

**BY**

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## **ABSTRACT**

Islamic banks now operate in competition with other Islamic banks, foreign Islamic banks and also with conventional banks offering banking products and services based on Islamic principles. However, it is known that the intense competition in the banking industry results in providing better services and competitive products to customers. The aim of this research, hence, is to examine service quality dimensions that contribute to customer satisfaction towards Islamic banks and to explore which dimensions has the most influence on the satisfaction. Besides, this study also examines the relationship between customers satisfaction and loyalty towards Islamic banks. This study utilises the PAKSERV model, a cultural based instrument to measure the service quality in Malaysian Islamic banks. In responding to the aims of this study, a questionnaire survey was distributed in Kuala Lumpur and Selangor areas involving 363 respondents. Data was analysed using PLS-SEM. The result shows that from seven service quality dimensions proposed in this research, only five have positive significant relationships with customer satisfaction. Compliance, the additional dimension, had been found to be the most influential dimension. The second, third and fourth dimension are originated from PAKSERV namely, sincerity, personalization and formality. Meanwhile, the least important dimension is reliability which is originated from the established SERVQUAL developed based on Western context. Other insignificant variables also originated from SERVQUAL, namely tangibility and assurance. Lastly, this study had again proved the relationship between customer satisfaction and loyalty when it shows a positive significant result between the variables. The findings of this study will help the managers of Islamic banks to further enhance the service quality of their organizations.

## خلاصة البحث

تتنافس البنوك الإسلامية حالياً مع البنوك الإسلامية الأخرى والبنوك الإسلامية الأجنبية، وكذلك مع البنوك التقليدية التي تقدم منتجات وخدمات بنكية حسب القواعد الإسلامية. ومع ذلك، فمن المعروف أن المنافسة القوية في المجالات البنكية تعمل على تقديم خدمات أفضل للعملاء وتوفير منتجات تنافسية. والهدف من هذا البحث هو دراسة أبعاد جودة الخدمة المساهمة في إرضاء العميل تجاه البنوك الإسلامية، وكذلك لبحث أي الأبعاد ذات التأثير الأكبر على مدى هذا الرضاء. إلى جانب ذلك، تبحث هذه الدراسة أيضاً العلاقة بين رضاء العميل وولائه تجاه البنوك الإسلامية. وقد تم في هذه الدراسة استخدام نموذج PAKSERV، القائم على الأبعاد الثقافية، لقياس مدى جودة الخدمة المقدمة في البنوك الإسلامية الماليزية. ولتحقيق أهداف هذه الدراسة، فقد تم توزيع استبيان ضم 363 مشارك في كوالالمبور ومنطقة سيلانغور. وتم استخدام البرنامج التحليلي PLS-SEM في تحليل البيانات. وقد أظهرت النتائج أن خمسة فقط من أبعاد جودة الخدمة السبعة المقترحة في هذا البحث كانت لها ارتباطات إيجابية واضحة مع رضاء العميل. ووجد أن الالتزام وهو البعد الإضافي، كان البعد الأكثر تأثيراً في تحقيق رضاء العميل. أما البعد الثاني والثالث والرابع فقد أستخرجت عن طريق PAKSERV، وهي: الإخلاص واضفاء الطابع الشخصي والشكليات. في الوقت ذاته، وكان البعد الأقل أهمية هو الموثوقية والذي أستخرج من أبعاد SERVQUAL والتي تم تطويرها أيضاً على أساس سياق غربي. وقد تم استخراج متغيرات غير هامة من خلال SERVQUAL، وهي: أن تكون ملموسة ومضمونة. وأخيراً فقد أثبتت هذه الدراسة العلاقة الوثيقة بين رضاء العميل وولائه وبصفة خاصة عندما تظهر نتائج إيجابية واضحة بين المتغيرات. وستساعد نتائج هذه الدراسة مدراء البنوك الإسلامية على تعزيز وتحسين جودة الخدمات التي تقدمها منظماتهم.

## APPROVAL PAGE

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In the name of *Allah*, The Most Compassionate, The Most Merciful. Alhamdulillah, all praise be to *Allah*, the most gracious and the most merciful. May His peace and blessings be upon our beloved Prophet Muhammad Sallallaahua'laihiwasallam and upon his family, his companions and all his followers after him. My utmost thanks to *Allah* for His blessings and for granting me the persistence and the endurance to complete this thesis successfully.

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## **LIST OF ABBREVIATION**

<b>BIMB</b>	Bank Islam Malaysia Berhad
<b>BNM</b>	Bank Negara Malaysia
<b>CIMB</b>	Commerce International Merchant Bankers
<b>PwC</b>	PricewaterhouseCoopers
<b>IFSA</b>	Islamic Financial Services Act

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 INTRODUCTION**

As an introductory chapter, this section targets in providing an overall summary of the study. It initiates the research topic with a highlight on the study background (sub-section 1.2) in which the details are further elaborated in chapter two. The following sub-section presents problem statement (sub-section 1.3), followed by research questions (sub-section 1.4), research objectives (sub-section 1.5), study significance (sub-section 1.6) and scope of the study (sub-section 1.7). Later, the chapter will enlighten the operational definitions of the study constructs (sub-section 1.8) and the organizations of the proposal thesis (sub-section 1.9).

### **1.2 STUDY BACKGROUND**

The emergence of Islamic banking in the Muslim world is one the most inspiring financial and economic phenomenon of the 20th century (Mustapha, Ibrahim & Adewale, 2011). Moreover, the financial crisis a few years back has revealed the flaws of the capitalist financial system and strengthen the fact that the Islamic finance system is more resilient and stable (Smolo & Mirakhor, 2010). Over the last few decades, the Islamic banking industry is growing not only in Islamic countries but also expanding around the globe, especially Asia region and surely, five out of the top 10 countries embracing Islamic banking are among those who have the largest Muslim populations (cpi financial.com, 2016).

In this light, the growth of Islamic banking was highlighted by Mohamad Safri Shahul Hamid, Senior Managing Director and Deputy Chief Executive Officer of CIMB Islamic who mentioned, “There are more than 600 Islamic financial institutions operating in more than 75 countries, offering a wide range of products and services. In the last decade the growth has been well documented, with total global Islamic banking assets growing at a compound annual growth rate of more than 40 percent globally and the size of Islamic banking assets is estimated at \$1.35 trillion globally which approximately represents 1.3 percent of the total global banking assets” (cpi financial.com 2016).

According to PwC (2016), the Islamic finance industry will gain more than double to \$2.6 trillion by 2017 with Middle East, North Africa and Asia regions accounting for a large part of that growth. The World Bank has recently released a statement noting that in countries where Muslims are in majority, the Islamic banking assets have been growing 50 percent faster than conventional banking assets (cpi financial.com 2016). The outlook continues to appear very bright for the industry.

This growth is influenced by the attraction of participation not only from Muslim customers, but also non-Muslim customer s. In an increasingly competitive and liberalised global banking industry, the competition to attract and retain Muslim and non-Muslim customers is likely to increase. In this light, Islamic banking is established to Muslim to conduct their banking activities, but also to attract the non-Muslims (Loo, 2010). In regards to the acceptance of non-Muslim, Amin and Isa (2008) expressed that Islamic banking is not merely of interest to Muslim customers as the non-Muslims customers could also see the benefits of such system.

Based on the ideas of having both Muslim and non-Muslim customers, Malaysia is practicing a ‘dual system’ model where both the full-fledged Islamic

banking system and the full-fledged conventional banking system are operating side-by-side. They particularly have choices to use either Islamic banks or conventional banks or maybe, both of it. Therefore, Islamic banks can no longer be regarded as business organisations established to fulfil religious duties, but what more important, is to be as competitive as possible, side by side with the conventional system in attracting more customers and in retaining them.

Inevitably, Islamic banks really need to understand the perceptions of their customers towards their business operations, particularly, their quality of service rendered, to increase customer satisfaction and ultimately their loyalty (Dusuki & Abdullah, 2007). In order to compete in the present situation of robust rivalry, Islamic banks have been advised to expand their effective marketing strategies, or in other words, there is a need for Islamic banks to create and maintain better service quality and customer satisfaction (Amin & Isa, 2008). Even though there is a high interest in the adoption of Islamic banking products and services from the people, Islamic banks have been successful when it comes to meeting the customer standards of interaction quality during service encounters (Ahmad, Rustam & Dent, 2011).

Nowadays, customers have become more knowledgeable and educated which leads organisations, especially the banking sector which is aware about the level of customer's satisfaction, regarding the services and products being offered (Hamzah, Ishak & Nor, 2015). However, the question remains whether their Islamic bank service qualities meet the requirements of up-to-the-minute customers, as customers are more responsive to the latest innovations (Kamal, 2008).

Therefore, this is where service quality topics came in. In the service literature, a strong emphasis has been placed on the importance of service quality perceptions and the relationship between service quality and customer satisfaction (Cronin &



Taylor, 1992; Taylor & Baker, 1994). The rapid development and competition of service industries, in both Western and non-Western countries, has made it important for companies to measure and evaluate the quality of service encounters (Brown & Bitner, 2007).

As identified by past research, they have emphasised the significance of managing service quality where it provides a differential character of a service organisation which directly would give the company competitive advantages leading to more sales and profits (Shariff, 2013). Concurrently, service quality issues have also flourished in the area of Islamic banking, which is relatively a very young industry when it is been compared to conventional banking (Shariff & Al-Adwani, 2012). The improvement of the service quality will retain Islamic banking competitiveness and attractiveness (Shariff, 2013). Moreover, to increase their product selection, conventional banks have put an effort in producing Islamic windows within the conventional global financial institutions (Amiri, 2008). Hence, increasing competition makes service quality an important factor, in reaching the competitive advantageous position for individual Islamic banks.

Over the last three decades service quality researchers have popularised various tools to measure service quality. However, these traditional models are all developed in the Western contexts which do not truly represent other contextual paradigms while reporting service quality (Kashif, Shukran, Rehman, & Sarifuddin, 2015). Literature pertaining to service quality has been reported mostly in Western and USA settings where an Asian perspective is seriously lacking (Frimpong & Wilson, 2013).

It is important to know that, service quality can only become a useful tool, if it is been measured by conducting appropriate measurement as there is a hot debate on

the usefulness of these traditional tools in applying towards others cultures. This is because, as explained by Rajpoot (2004), service quality is a subject of a cultural phenomenon. The most well-known measures, SERVQUAL, had also been criticised despite its big usefulness. It is been said that, SERVQUAL does not truly represent other contextual paradigms while reporting service quality (Kashif, Rehman & Pileliene, 2016) and the scales that have been created for individualist culture cannot be replicated to a collectivist culture (Strandberg, Wahlberg & Othman, 2012).

The difference of cultural contexts presents both marketing opportunities and challenges for service marketers (Kashif et al., 2015). Culture represents the totality of living hood in a society which has been employed by marketers to stimulate product and service purchase (Lowe & Corkindale, 1998). In addition, service quality must be investigated specifically in accordance with the local cultural conditions (Ladhari, Souiden & Ladhari, 2011) or in other words, the scale being employed to measure service quality must be aligned with the local cultural setting.

In order to overcome this problem, Raajpoot (2004) had developed a model specifically for a non-Western cultural context called as PAKSERV. It has been developed in a collectivist country; Pakistan and the dimension tested were significant. However, in PAKSERV model, there is a lack of a dimension related to Islamic bank characteristics. Past research, provided useful insights for service quality in Islamic banking context where dimension related to the ability of Islamic banks to comply with the Islamic ruling and principles is also significant (Othman & Owen, 2001, Muslim & Zaidi, 2007). Since service quality issue remains critical particularly in ensuring customers satisfaction and loyalty, thus this study aims to examine service quality of Malaysian Islamic banks using the PAKSERV approach.

### **1.3 STATEMENT OF THE PROBLEM**

In Malaysia, both Islamic banks and conventional banks operate side by side (Amin & Isa, 2008). They were a dual-window banks that had been placed under the Islamic Banking Scheme where they offer Islamic banking products and services, but still operates in parallel with the conventional banking system. Inescapably, Islamic banks are presently facing not only a booming intra-industry competition (among Islamic banks) but also a strong inter-industry rivalry (Islamic system and conventional system) where it is a must for Islamic banks to be competitive and call for a creative strategy in retaining its customer and to acquire customers (Maulan, 2014).

The survival of Islamic banks is indeed important not only to ensure its continuing existence but also the essential needs for the Muslims. The establishment of Islamic banks are not only to fulfil an individual's financial needs but it is also regarded as an effort to restore the application of *Shariah* in all aspect of the life of a Muslim (Billah, 2007). Furthermore, Islamic banking is not merely of interest to Muslim customers but clearly towards non-Muslims customers. Plus, with the increasingly competitive and liberalised global banking industry, the competition in attracting and retaining both Muslim and non-Muslim customers is likely to increase (Amin & Isa, 2008).

In addition, when it comes to organisational performance measures, service quality remains at the forefront of both the marketing literature, generally, and specifically the service marketing literature (Jensen & Markland, 1996). During the past three decades, academics (Cronin & Taylor, 1994; Teas, 1993; Parasuraman, Zeithaml & Berry, 1985; Gronroos, 1984) have increasingly evaluated the important features of service quality and its measurement, as any organisation that hopes for success should understand the customer's thought of service quality which affects the

customer's choice of service provider, satisfaction and their loyalty (Islam, Ahmed & Razak, 2015).

However, according to Saleem (2005), Islamic banks put a little effort in increasing their service quality, especially if they enjoy a position where they can exercise some monopolistic control in the market, which most of the time is based on religious legitimacy (Shariff, 2013). Consequently, the monopolistic position is actually deteriorating, due to the increasing number of Islamic banks in many countries and the entry of conventional banks into the Islamic finance market (Saleem, 2005).

Inherently, there is a need for Islamic banks to expand and maintain better service quality but, it seems that, Islamic banks are struggling to meet customer expectations of service quality (Taap, Chong, Kumar & Fong, 2011). Even though there is a high interest in the adoption of Islamic banking products and services, Islamic banks are still facing a problem in meeting customer standards, particularly the interaction quality during service encounters (Ahmad et al., 2011).

Currently, the prospective roles of Islamic banking in transforming their marketing strategy towards a better practice of service quality in their institutions have not been sufficiently scrutinised (Shariff, 2013). In this regard, there is a need for Islamic banks to make a move to increase their quality level of service. In maintaining the survival of Islamic banking industry, past researchers have increasingly evaluated the important features of service quality and its measurement as study is proven that service quality is a key for survival. However, despite its great effect, service quality can only become a tool to guard competition and survival, if it is measured by conducting appropriate tools (Kashif et al., 2015).

Most traditional models of service quality had shared the same flaws where, the measurement scales, are all developed in the Western context (Rajpoot, 2004). In the case of culture it is clearly seen that each culture has its own character especially, for example, when it is compared between the Western and Asian contexts. Over the last ten years, service marketing researchers have questioned about SERVQUAL's applicability to suit different country contexts (Tsoukatos & Rand, 2007; Kueh & Voon, 2007). Consequently, this has led to unsatisfactory and unsuitable marketing strategies in some other countries and other cultural contexts (Laroche, Uelschy, Abe, Cleveland, & Yannopoulos, 2004).

So far, there were numerous literatures on the quality of Islamic banking services but there is a lack of cultural context. In order to overcome this problem, Raajpoot (2004) had developed a non-Western cultural context model called PAKSERV, due to the fact service quality and customer satisfaction is a cultural phenomenon (Malhotra, Ulgado, Agarwal, Shainesh & Wu, 2005). This is because service formation is different. Therefore, service marketing researchers have highly recommended the idea to establish culturally sensitive scales, so that it can be beneficial when it comes to formulating customised marketing strategies (Winsted, 1997; Raajpoot, 2004; Malhotra et al., 2005).

Even though PAKSERV takes into account the cultural context in its scale, its applicability in measuring service quality for Islamic banks in Malaysia is still in doubt. Malaysia is a multi-cultural country where they live side by side peacefully. The Malays are the largest community where Malaysian citizens consist of the ethnic groups *Bumiputera* (Department of Statistic, 2015). Islam is the most widely professed religion in Malaysia with the proportion of 61.3 percent and other religions practiced include Buddhism (19.8%), Christianity (9.2%) and Hinduism (6.3%)

(Department of Statistic, 2015), this leads Malaysian Islamic bank to have different customers backgrounds. Initially, Islamic banking was established for Muslims customers, however it has also attracted the non-Muslims over the recent years (Loo, 2010) and it is been agreed by Amin and Isa (2008) that Islamic banking is no longer garnered the attention of Muslim customers, but also non-Muslims customers.

More importantly, there is lack of consideration of customer's religious affiliation as researchers discussed the limitation of study and it creates an area for further investigation. Therefore, in fulfilling this gap, this study aims to employ the PAKSERV approach with the consideration of 'compliance' dimension in examining the service quality of Malaysian Islamic banks. Specifically, research question and objectives are devised pertaining to the dimensions of modified PAKSERV model of service quality in creating customer satisfaction and loyalty.

#### **1.4 RESEARCH QUESTION**

In light of the study justification and problem statement, this thesis aims to answer the following research question:

1. What are the service quality dimensions that contribute to the customers satisfaction towards Malaysian Islamic banks?
2. Which of the service quality dimension has the most influence on customer satisfaction towards Malaysian Islamic banks?
3. What is the relationship between customer satisfaction towards Malaysian Islamic banks and their loyalty?

## **1.5 RESEARCH OBJECTIVE**

Accordingly, a conceptual framework is developed and the research objectives are outlined as follows:

1. To examine the service quality dimensions that contributes to the customers satisfaction towards the services offered by the Malaysian Islamic banks.

Based on the PAKSERV approach, the sub-research objectives are:

- i. To examine the influence of reliability on customers satisfaction towards Malaysian Islamic banks.
  - ii. To investigate the influence of tangibility on customers satisfaction towards Malaysian Islamic banks.
  - iii. To examine the influence of assurance on customers satisfaction towards Malaysian Islamic banks.
  - iv. To investigate the influence of sincerity on customers satisfaction towards Malaysian Islamic banks.
  - v. To determine the influence of formality on customers satisfaction towards Malaysian Islamic banks.
  - vi. To examine the influence of personalization on customers satisfaction towards Malaysian Islamic banks.
  - vii. To determine influence of compliance on customers satisfaction towards Malaysian Islamic banks.
2. To identify the service quality dimension that has the most influence on customer satisfaction towards Malaysian Islamic banks.
  3. To determine the relationship between customer' satisfaction and loyalty towards Malaysia's Islamic banks

## **1.6 STUDY SIGNIFICANCE**

Theoretically, the study is significant as it contributes towards service quality literature, particularly in the context of Islamic banking. The use of PAKSERV model with the additional dimension of ‘compliance’ also enriches the measurement and scales that can be used further. PAKSERV is a new model which had been proved by past researcher that it is suitable measures in measuring service quality in non-Western context. In this regard, this recent service quality tool helps organisations in shaping their future direction which is aligned with current updates.

Practically, this study provides insights to Islamic bank managers on how to improve services offered and reconstruct the marketing strategy in achieving customers satisfaction. In this regard, this study identified the dimensions that are significantly contribute of customer satisfaction. In addition, to make it more beneficial for organisations and managers in implementing effective marketing strategies, this study also, identified the most important dimensions of service quality that influence customer satisfaction.

It is also important to note that customer satisfaction can be an essential factor in customer retention and new customer take up where the loyalty comes up. Customer satisfaction determines the likelihood of repurchase intentions which would create loyalty. In this regard, this study had offered some confirmation regards to the relationship of Malaysian Islamic banks customers satisfaction and their loyalty. Thus, it is a starting point for organisations to create strategies based on that relationship to retain their customers.

This study is significant for policy makers. They can use the findings to revise their strategies. They could expand the scope in considering other means to