



THE MEDIATING ROLE OF CUSTOMER  
SATISFACTION TOWARDS CUSTOMER LOYALTY IN  
THE MOTOR *TAKAFUL* INDUSTRY IN MALAYSIA

BY

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## ABSTRACT

Customer loyalty is the key to profitability and survival to a particular firm. Loyal customers would purchase from the firm over an extended time while satisfied customers are more likely to be repeat customers and even become loyal customers. *Takaful* (Islamic insurance) industry is experiencing significant expansion in the past two decades, mainly in Islamic countries and countries with large Muslim communities. Even though customer satisfaction and customer loyalty are considered fundamental in the profitability and survival of motor *Takaful*, few researchers have attempted to link customer satisfaction to customer loyalty in this industry. This study aims to determine the effects of the three exogenous variables, namely service quality, price fairness and *Shari'ah* compliance on customer loyalty through customer satisfaction as the mediator. Applying the theory of customer satisfaction, a structural equation model was developed and tested on 322 respondents from the Klang Valley, using a self-developed questionnaire. The findings suggest that customer satisfaction partially mediates the relationship between the independent variables of *Shari'ah* compliance and price fairness and the dependent variable, customer loyalty. The theory is partially supported where only price fairness and *Shari'ah* compliance are significantly correlated with customer loyalty while customer satisfaction mediates their relationships. *Shari'ah* compliant framework provides motor *Takaful* operators a competitive edge over their conventional motor insurance operators. Therefore, motor *Takaful* operators must be very transparent in their pricing policies; customers would not mind if they know what exactly they are paying for even though the price is higher. This study contributes significantly to the motor *Takaful* operators in focusing on their core areas of competency in preparation for the implementation of the deregulation of tariffs by 2016. The deregulation of compulsory motor insurance/*Takaful* pricing will create strong competition from new and existing players and set off unhealthy undercutting.

## ملخص البحث

مثابة الخطوة الأساسية لتحقيق الأرباح واستمراريتها خاصة في يُعد إرضاء الزبون أو ما يسمى أحياناً بالعميل شركات التكافل. لذلك فإن الوفاء واحترام الزبائن سيؤدي حتماً إلى استمرارية هذه الأرباح. وتحقيق الأرباح بديمومة الوفاء الذي يتلقونه الزبائن من تلك الشركات على المدى البعيد مادام الزبائن راضين عن الخدمة المقدمة لهم. لتحقيق هذه الغاية برز دور الوسطاء وأثر ذلك على سير حركة التكافل الإسلامي الذي يعرف أيضاً (بالتأمين الإسلامي). الذي أصبح يتوسع على نطاق الدول الإسلامية وأكثرية المسلمين في الدول غير الإسلامية بصورة دراماتيكية في خلال العشرين عاماً المنصرم. بالرغم من أن رضى الزبون بخدمة التكافل المقدمة له واحترامه من قبل شركات التكافل يُعد الحجر الأساسي لتحقيق الأرباح وضمان استمرارية التكافل، إلا أن القليل جداً من الباحثين فكروا جدياً لمعرفة أثر بعض العوامل التي تؤثر على ذلك. إذ أنه تمّ تقييم أثر المتغيرات الخارجية والتي تضمنت: جودة الخدمة، وتوحيد السعر بين المستفيدين، والالتزام الشرعي، وأثر ذلك على إرضاء الزبائن. لتحقيق هذه الأهداف تمّ استخدام نظرية إرضاء الزبائن والعملاء. أجريت الدراسة على 322 فرداً عن ( بدولة ماليزيا لمعرفة رأي الزبائن. أوضحت Klang Valley طريق الاستبيان الشخصي بمنطقة كلانج ) نتائج الدراسة بأن إرضاء الزبون يُعد العامل الأساسي الذي يوضح علاقة الارتباط بجزئي للمتغيرات المستغلة مثل: الالتزام بمبدأ الشريعة، والسعر الثابت الموحد بين الزبائن، واحترام الزبون كمتغير غير مستغل. أيضاً أشارت النتائج المتحصل عليها بأن هناك علاقة ارتباط معنوي بين السعر الموحد بين الزبائن والالتزام بتطبيق الشريعة خلال عمليات تطبيق التكافل الإسلامي فيما يخص إرضاء الزبون المتعامل معه. ومن المهم جداً أن الإلتزام بمبدأ الشريعة من خلال تطبيق التكافل الإسلامي هذا بدوره يحفز فرص التكافل واستمراريتها لأن ذلك يتغلب على كبح جماح المنافسين الذين يمارسون التكافل التقليدي. لذا فإن على الأشخاص والشركات العاملين في مجال التكافل الإلتزام بالشفافية خاصة في الأسعار لأن معظم الزبائن الذين شملتهم الدراسة يجهلون بالضبط ما يجب عليهم دفعه بالرغم من غلاء الأسعار والتفاوت فيها. تُعد هذه الدراسة مهمة جداً لمساهمتها في معرفة سير حركة التكافل الإسلامي تطبيقاً وتنفيذاً والعلاقة بين الأفراد المستفيدين كزبائن، ودور الأفراد المتنافسين كوسطاء وأثرهم على قرارات تنفيذ التعريفات أو ما يسمى بالسعر الرسمي وإمكانية التلاعب بالسعر الرسمي خارج مظلة الرقابة الحكومية وذلك خلال العام 2016م نموذجاً. وأخيراً، أوصت الدراسة بأن تطبيق فئة التكافل دون رقابة الحكومة بإمكانه أن يكون عاملاً رئيساً في التنافس القوي بين الوسطاء الجدد والقدامى في مجال التكافل الإسلامي وهذا بدوره سيؤدي إلى تذبذب الأسعار، وسمعة الشركات في نفوس الزبائن، وعدم رضاهم نتيجة لجشع الوسطاء الناجم عن ذلك

## **APPROVAL PAGE**

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## DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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*This dissertation is dedicated to my wife, Sam*

*& children,*

*Michelle & Michael,*

*for their love, respect and patience.*

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## LIST OF ABBREVIATIONS

<b>Abbreviation</b>	<b>Description</b>
ACSI	American Customer Satisfaction Index
AGFI	Adjusted Goodness-of-Fit Index
AMOS	Analysis of Moment Structure
ANOVA	Analysis of Variance
ASV	Average Shared Variance
AVE	Average Variance Extracted
BC	Before Christ, an era used in dating years prior to the birth of Jesus
bn	Billion
BNM	Bank Negara Malaysia (Central Bank of Malaysia)
CFA	Confirmatory Factory Analysis
CFI	Comparative Fit Index
CMIN	Normed Chi-Square
CL	Customer Loyalty
CMB	Common Method Bias
CR	Critical ratio
CS	Customer Satisfaction
df	Degree of Freedom
DV	Dependent Variable
EFA	Exploratory Factory Analysis
et al.	et alia (and others)
FA	Factor Analysis
FSA	Financial Services Act
GFI	Goodness-of-Fit Indices
GOF	Goodness-of-Fit
GSM	Graduate School of Management
IBFIM	Islamic Banking & Finance Institute Malaysia
IFSA	Islamic Finance Service Act
IUM	International Islamic University Malaysia
INCEIF	International Centre for Education in Islamic Finance
IV	Independent Variable
JPJ	<i>Jabatan Pengangkutan Jalan</i> (Road Transport Department)
KMO	Kaiser-Meyer-Olkin
M	Mean
MSV	Maximum Shared Variance
MI	Modification Indices
MTA	Malaysian <i>Takaful</i> Association
p	P-value
PF	Price Fairness
PIAM	<i>Persatuan Insurans Am</i> Malaysia (General Insurance Association of Malaysia)
r	Loadings

RM	Ringgit Malaysia (Malaysian Currency)
RMSEA	Root Mean Square Error of Approximation
SC	<i>Shari'ah</i> Compliance
SD	Standard Deviation
SEM	Structural Equation Modelling
Sig.	Significance/Significant
SPSS	Statistical Package for Social Science
SQ	Service Quality
TLI	Tuck-Lewis Index
USD	United States Dollars
VIF	Variable Inflation Factor

# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

Customer loyalty is essential to profitability and strength to an individual business (Lombart & Louis, 2012; Srinivasan, Anderson & Ponnayolu, 2002). Loyal customers are satisfied with their purchase and would patronize the company over a long period (Evans & Berman, 1997) while satisfied customers are expected to be regular customers and finally become loyal customers (Gultinan, Paul & Madden, 1997). Loyalty is defined as the strong backing for a friend, a family member, or a company by Cambridge International Dictionary of English (1995). Marketing researchers have defined customer loyalty in many dissimilar ways (Jacoby & Chestnut, 1978). McIlroy and Barnett (2000) state that “customer loyalty is a level of how a customer will continue buying a product”. In addition, many companies have acknowledged the importance of loyal customers and the requirement for accepting customer loyalty (Buckinx, Verstraeten & Poel, 2007). Bansal and Gupta (2001) indicate in order to upholding competitive advantage there must be customer loyalty. Therefore, the eventual strategy of a company is to practise customer loyalty (Sivadas & Baker-Prewitt, 2000; Siddiqi, 2011).

Customer satisfaction is the dynamic pointer of the customer loyalty to a specific business (Danesh, Nasab & Ling, 2012). It is detected that the customer satisfaction is the main cause of lasting customer undertakings for improving the customers’ loyalty and customers’ withholding. Customer satisfaction is an antecedent of purchase intent, word-of-mouth, customer loyalty and eventually,

continuing profitability of a firm (Athiyaman, 2004; Bearden & Teel, 1983; Fornell, 1992; LaBarbera & Mazursky, 1983; Oliver, 1980, 2010). Therefore, customer satisfaction is the most important factor to promote the possible growth of a company.

Satisfied customers are faithful and frequently become loyal customers (Young, 2012). Therefore, there is a common statement that satisfaction is expected to increase loyalty (Oliver, 1980). The final objective of customer satisfaction should lead to customer loyalty (Sivadas & Baker-Prewitt, 2000). Harkiranpal Singh (2006) states “that successful business can be determined by on the level of customer satisfaction, loyalty, attraction and retention”. Therefore, it is important for firms to successfully manage customer satisfaction and customer loyalty.

This study develops the understanding of customer satisfaction and customer loyalty towards motor *Takaful* in Malaysia. It is mandatory to have a motor insurance/*Takaful* policy/certificate to operate a vehicle on Malaysian roads. Yet research on customer satisfaction and customer loyalty is relatively limited. This research is relevant from an Islamic perspective, since Muslims prefer to participate in (purchase) insurance which is *Shari’ah* compliant.

## **1.2 THE MAIN CONCEPT OF INSURANCE**

The key idea of insurance has been around for as long as humans’ existence. The Chinese were the early people to practise a form of insurance (INCEIF, 2012; Vaughan, 1997). In about 3000 BC, the Chinese traders applied the concept of risk separation while travelling through the torrents and ravines of Yangtze and Yellow rivers. They dispersed their goods on many different ships so that if one ship sank, the

entire goods would not be lost. This was to protect the loss of all goods on a ship from piracy or sinking. In such an event, the trader would lose only a part of the entire shipment.

The earliest printed insurance policy appeared in the middle of 17th century on a Babylonian pillar with the code of King Hammurabi engraved on it (INCEIF, 2012; Vaughan, 1997). It presented a form of simple insurance in that a borrower did not have to pay back his loans if some personal disaster made it impossible. In the late 17th century, the beginning of Lloyd's of London was in the coffeehouses of London. Affluent traders sponsored journeys in exchange for profits from goods the colonists discovered or manufactured from the New Continents and other colonies. Shipping was established between the New Continents and the colonies. Lloyd's of London was established in the late 19th century, and the company was incorporated by the British Parliament under the Lloyd's Act. The Act certified that investors would be guaranteed some of the profits from the goods the colonists would yield (INCEIF, 2012; Vaughan, 1997). In middle of 18th century, the earliest fire insurance company in the United States, the Philadelphia, was established by Benjamin Franklin. In late 18th century, the earliest life insurance company in the United States, the Presbyterian Ministers Fund was established. Subsequently, there was a need for Muslims to join in to insure themselves in the Islamic way. As a result, the earliest Islamic insurance (*Takaful*) in Sudan to provide a variety of *Shari'ah* compliant products emerged.

The role of insurance was formed as a transfer of risk by an individual or business, known as the insured to an insurance company. The insurance company receives payment in the form of premium in exchange for an approved sum. In the event of loss or damage suffered by the insured, the insurance company will reimburse

for the loss or impairment specified in the insurance policy (Barr, 1968). Archer, Rifaat and Nienhaus (2009: 9) define “traditional insurance as an exchange of premium payment today for future coverages in case of indicated happenings”. However, traditional insurance has certain features that contradict some of the essential values of an Islamic financial contract. Insurance is a very old idea within Islam. It includes pure risk and speculative risk. In speculative risk there may profit or loss while in pure risk, loss may or may not occur (INCEIF, 2012). *Takaful* (Islamic insurance) is only associated with pure risk and not with speculative risk. *Takaful* applies the reimbursement principle and reimburses the loss of a *Takaful* participant; the principle of a personal safeguard against loss or disaster is applied.

*Takaful* is interpreted from the Arabic origin word *kafalah* which means "guaranteeing each other". A participant accepts a contract (*aqad*) to become one of the participants by agreeing to mutual cooperation (*ta'awun*) with each other, should any of the participants suffer a clear loss (Nasser & Jamil, 2011). Each participant may justify his/her requirement by subscribing an amount of *tabarru'* (donation) into a fund. This fund will be managed by a third party known as *Takaful* operator. In the occurrence of loss or injury, the *Takaful* operator will distribute the funds properly to its participants. Any surplus is distributed only after the responsibility of assisting the participants has been satisfied. Therefore, *Takaful* operates as a security and profit sharing undertaking between the *Takaful* operators and its participants (INCEIF, 2012; Nasser & Jamil, 2011). The participants would not be requested to pay extra contribution, if the fund is inadequate. The law requires *Takaful* operators to provide interest-free credit, identified as *Qard Hasan* (benevolent credit) from the shareholders' fund to meet the shortfall (Archer et al., 2009; INCEIF, 2012). This

advance can be recovered from impending underwriting proceeds.

Muslims are engaged by their belief to follow a trail of morality in going through their daily events. Insurance should avoid the elements of *riba* (interest), *maisir* (gambling) and *gharar* (uncertainty) to be accepted by Muslims (Archer et al., 2009; IBFIM, 2010; INCEIF, 2012). Traditional insurance includes *riba*, *maisir* and *gharar* which are in contradiction of *Shari'ah* (Islamic Law). *Riba* is used in Arabic language which means excess or extra in something. The operator involves in investments that may develop their proceeds from interest and/or prohibited businesses. This procedure is similar to *riba* (usury) and/or akin to *haram* (prohibited) activities. Advance without interest is allowed in Islam and if interest is charged then it is *haram* (prohibited) and against *Shari'ah*. *Gharar* is uncertainty in a agreement where one party's profit and loss are suffered by another party. In the situation of an insurance agreement, *gharar* may mean there is no knowledge about the payment as pledged or how much should be paid at the time of loss or misfortune. However, some elements of *gharar* may be allowable depending on the situations. A policyholder participates a small amount of premium with the anticipation to gain a great profit and sometimes he/she may lose on the premium spent, this is known as *Maisir* in insurance. Therefore, *maisir* signifies gaining or attaining something without any work which is like in gambling. So, when the insurance company takes premiums from the insured at a level which it expects will cover claims and create a profit. This procedure of expectation is akin to *maisir*. Islam is not against the concept of insurance itself but against some of the means and methods that are currently used in traditional insurance (IBFIM, 2010). The insured pays premiums to the company in exchange for protection against risks that may not happen. This procedure of

uncertainty is similar to *gharar*. Under *Shari'ah* due to the *gharar* (the value of future guarantees), the exchange of risk for a fees or an exchange of sale agreement in insurance would not be binding (Archer et al., 2009). Under *Shari'ah*, an agreement of exchange consists of the fundamental offer and acceptance and must meet the following five criteria:

- i. must happen at the time of exchange,
- ii. something of worth and suitable,
- iii. correctly possessed by the seller,
- iv. able to be conveyed by the seller, and
- v. distinguishable by category, quality and form (Nasser & Jamil, 2011).

In addition, every *Takaful* operator is imposed to set up a *Shari'ah* Advisory Committee, which instructs the management and certifies that their activities comply with *Shari'ah* principles. Therefore, the traditional insurance contract is deemed as *gharar* (uncertainty) because it does not satisfy all of these principles (IBFIM, 2010).

### **1.3 DEVELOPMENT OF TAKAFUL IN MALAYSIA**

In most of the Islamic countries and countries with large Muslim groups, *Takaful* business is facing major development in the previous twenty years (Lim, Muhammad Fahmi & Carissa, 2010). *Takaful* operations have established in the Middle East, namely Saudi Arabia, Bahrain, Iran, Qatar and later Egypt, the United Arab Emirates and Kuwait. *Takaful* operations in Malaysia have been measured as the forerunner and the fastest growing in South East Asia. Brunei, Indonesia and Singapore have all trailed with the expansion of *Takaful* operations.