Full Length Research Paper

Testing a model of Islamic banking based on service quality, customer satisfaction and bank performance

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This study analyzes the services quality of products offered by Islamic banks with mediating effect of customer satisfaction on bank performance. There is an increasing competition among banks to capture new customers as well as to retain existing customers. It requires a study to measure the impact of service quality on customer satisfaction towards bank performance. Data were collected from 720 respondents of 60 branches of six full fledged Islamic banks operating in Pakistan by simple random sampling. The researcher used PLS based SEM to assess the magnitude of the relationship among service quality, customer satisfaction and performance of Islamic banks. The results indicate a strong positive relationship between service quality and customer satisfaction, while weak positive correlation exists between service quality and bank performance, but negative relationship was found between customer satisfaction and performance of Islamic banks in Pakistan. Furthermore, it is found that customer satisfaction does not mediate between service quality and bank performance. The gap between customer satisfaction and bank performance may be due to bankers' concentration on network expansion instead of customer orientation and customer focus. This study enables the bankers, policy makers and researchers to identify the factors that could result a discrepancy between satisfaction and performance of banks.

Key words: Islamic banking, service quality, customer satisfaction, bank performance.

INTRODUCTION

Banking gained importance as an essential facility to promote business operations. In today's global and borderless market, product/service quality and customer satisfaction may increase the performance of banks for successful survival. Islamic bank plays a more active role for the economic development of any country by mobilizing the funds from savers (to provide these funds) to entrepreneurs. It helps to eliminate undue exploitation of different stakeholders that is created by interest based banking system. It also encourages welfare oriented business projects with high profitability that leads to improved quality of life. It is reported that Islamic banks have shown an excellent performance (Ebrahim and Joo, 2001).

Islamic banks play a vital role in the economy to promote productive activities that enhance economic growth and prosperity. Islamic banks ensure stable economy, fair distribution of income, reduce injustice, risk sharing, lesser financial crisis and facilitate production and business activities. It is suggested that banks should concentrate on service quality and customer satisfaction to gain competitive position in the market (Caruana, 2002). Similarly, it is recommended that service performance appraisal system of an organization should be improved in line with customer satisfaction in the banking sector (Kayis et al., 2003). However, it is found that there is direct and positive relationship between perceived quality and level of satisfaction (Iglesias and Guille´n, 2004).

Islamic banking system is growing rapidly during the last few years and proved its potential to work as a compatible and parallel alternative system for providing financial services. This study analyzes the perception of

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services quality of products offered by Islamic banks with mediating effect of customer satisfaction on bank performance. The acute shortage of literature regarding Islamic banking system inspired the researcher to conduct this study in Pakistan. The relationship between service quality and satisfaction of bank customers has been investigated in the different parts of the world, but there is severe shortage of studies regarding Pakistani banking sector. In Pakistan, no empirical research has ever addressed the issue of service quality, customer satisfaction and bank performance. It is an effort to fill this gap in the literature. Islamic banking practices are newly introduced in Pakistan which requires a study. This study enhances the body of knowledge in the field of banking by developing a local model of service quality, customer satisfaction and performance of Islamic banks in Pakistan. This study examines how service quality affects the customers' judgments towards satisfaction and its impact on the performance of the Islamic banks in Pakistan. It is reported that service quality is important for differentiation to compete in the market and retain the customers as satisfied for long-term benefits (Curry and Penman, 2004)

Previous research

Pakistani banks are dominant players of financial market having multiple opportunities in the recent age. It is found that services firms show poor performance due to lack of knowledge about customers' expectation (Zeithaml et al., 1990). There is an evident relationship between quality of services and profitability. The success of banks depends upon customers' willingness to stay with them (Ennew, 1996).

Newman and Cowling (1996) found that service quality is important for banks due to the link between quality, productivity and profitability. Similarly, it is reported that service quality has a significant impact on customers' satisfaction and their intentions to switch (Levesque and McDougall, 1996). Performance of banks could be measured as how they develop and maintain relations with their customers. Similarly, it is found that service quality is an important determinant of customer satisfaction by dealing with complaint behavior and commitment in Turkish banking industry (Yavas et al., 1997).

Parasuraman et al. (1985, 1991b) used SERVQUAL model to investigate the service quality. They explored ten dimensions of service quality and refined them into five dimensions. It was documented that an increase in service quality and professional behavior resulted a greater customer satisfaction and reduced customer erosion (Leeds, 1992). The relationship between service quality and customer satisfaction is becoming crucial with the increased level of awareness among bank customers (Sureshchandar et al., 2002). Also, it is reported that customers' perception of service quality differs in terms of gender, ethnicity, education and income (Urban and

Pratt 2000). However, an improvement in service quality is necessary for higher levels of satisfaction among banking customers (Allred and Adams, 2000). There are number of studies that investigated service quality perception of bank customers in the different parts of the world (Anakwue, 2002; Omar and Ogenyi, 2004).

Customer satisfaction is an important driver for better organizational performance especially in the banking sector due to increased competition. Several studies measured the relationship between customer satisfaction and performance of the firm (Anderson et al., 1994; Al-Hawari and Warid, 2006). However, there is a severe shortage of literature that specifically measured the performance of banks with reference to service quality and customer satisfaction. It is found that there is a significant relationship between service quality and financial performance (Duncan and Elliot, 2002). So it is concluded that superior delivery of services results into superior profitability (Kotler, 2003).

Mukherjee et al. (2003) found a relationship between resources, service quality and performance of banks. It is recommended that profit and loss sharing option is very attractive for the bank. It helps the bank to reduce risk and monitor costs (Ghannadian and Goswami, 2004), while it is found that customer satisfaction plays an inter-mediator role in the relationship between service quality and financial performance of the banks in Australia (Al-Hawari and Ward, 2006). However, understanding the changing needs and expectations of customers is an essential prerequisite for the financial sector (Joseph et al., 2005). Similarly, it is found that there is a positive relationship between service quality and customers satisfaction (Razak et al., 2007).

It is documented that customer satisfaction results into financial and non-financial customer value (Gritti and Foss, 2007). Likewise, it is suggested that customer satisfaction could increase bank efficiency by reducing divergence in efficiency scores (Tripe, 2007). It is reported that quality implementation initiatives mediate the relationship between service quality and bank performance (Akroush, 2008). The researcher proposed a local model of service quality, customer satisfaction and performance of Islamic bank in the light of existing literature to investigate the relationship among selected variables. The conceptual model is presented in Figure 1.

On the basis of the existing literature, this study examines the mediating role of customer satisfaction between service quality and bank performance in Pakistan to test the following hypothesis:

H$_1$: Customer satisfaction mediates the relationship between service quality and performance of Islamic banks in Pakistan.

METHOD OF THE STUDY

The researcher used a set of structured questionnaires in English to collect data from customers and employees of six full fledged
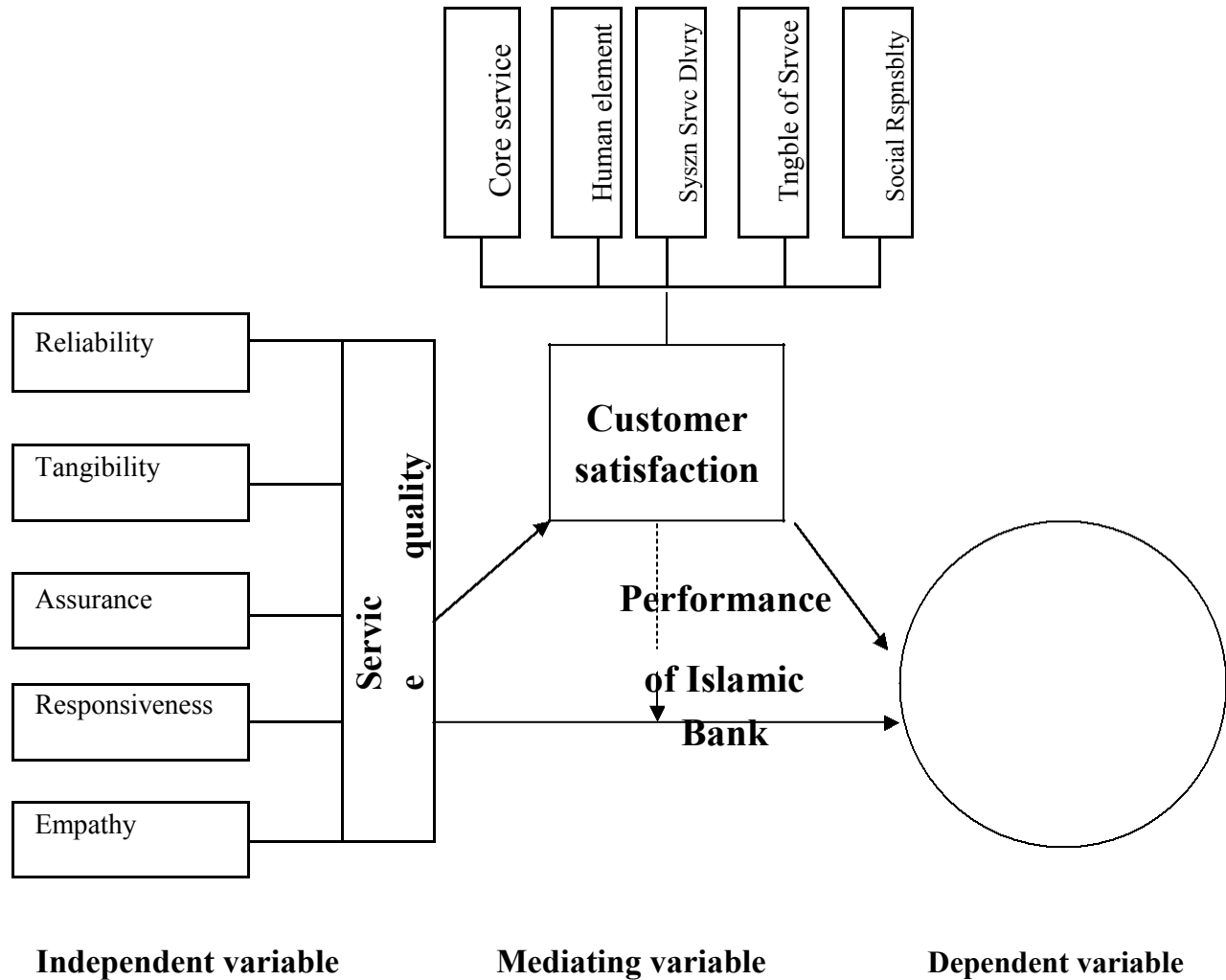
Figure 1. Conceptual model of service quality (Slty), customer satisfaction (Csrn) and performance of Islamic bank (Ipfc) in Pakistan.

Islamic banks, that is, Meezan Islamic Bank, Dubai Islamic Bank, Bank Islami Pakistan Ltd., Emirates Global Bank, Albaraka Islamic Bank and First Dawood Islamic Bank. This study selected 60 branches to collect data from 720 respondents in 10 major cities of Pakistan by simple random sampling. This study used PLS based SEM to investigate the relationships among service quality, customer satisfaction and performance of Islamic banks in Pakistan.

This study examines the relationship between service quality and customer satisfaction and further, on how it affects performance of Islamic banks. Structural equation modeling (SEM) technique was used to test the proposed model. The conceptual model was tested by using Partial Least Square method that is consistent with the past studies (Gefan et al., 2005). A survey was conducted using a structured questionnaire in order to measure the magnitude of the relationship among service quality, customer satisfaction and performance of Islamic banks in Pakistan.

Customers' responses regarding service quality were collected by a modified version of SERVQUAL model developed by Parasuraman et al. (1988, 1991). It contained 22 items divided into five dimensions, which are tangibility, reliability, responsiveness, assurance and empathy. Each item is assessed by a seven point

Likert scale as it stands for 1 = strongly disagree to 7 = strongly agree. Similarly, customers of Islamic banks were approached to collect data regarding their feelings of satisfaction or dissatisfaction towards bank services. Customer satisfaction was judged by a modified version of research instrument applied by Sureshchnader et al. (2002). It consists of 29 items that are classified into five dimensions which are: core service or service product, human elements of service delivery, systematization of service delivery (non-human element), tangibles of service (service scapes) and social responsibility. Customers' responses were evaluated on a seven point Likert scale ranging from 1 (reflects very high dis-satisfaction) to 7 (reflects very high satisfaction) with respect to all 29 items. However, performance of Islamic banks is measured by a modified version of an eight-item research instrument developed by Quinn and Rohrbaugh (1983). Every respondent was asked to rank a number of aspects regarding his/her bank, that is, quality of product, market share, internal process coordination, profitability, personnel rotation, etc. Bank performance was assessed by a five point Likert scale as 1 = Decreasing evolution to 5 = Increasing evolution. Here, evolution stands for development or progress (of that specific element) in relation to the specific bank in which the respondent is working. PLS is superior over the first generation
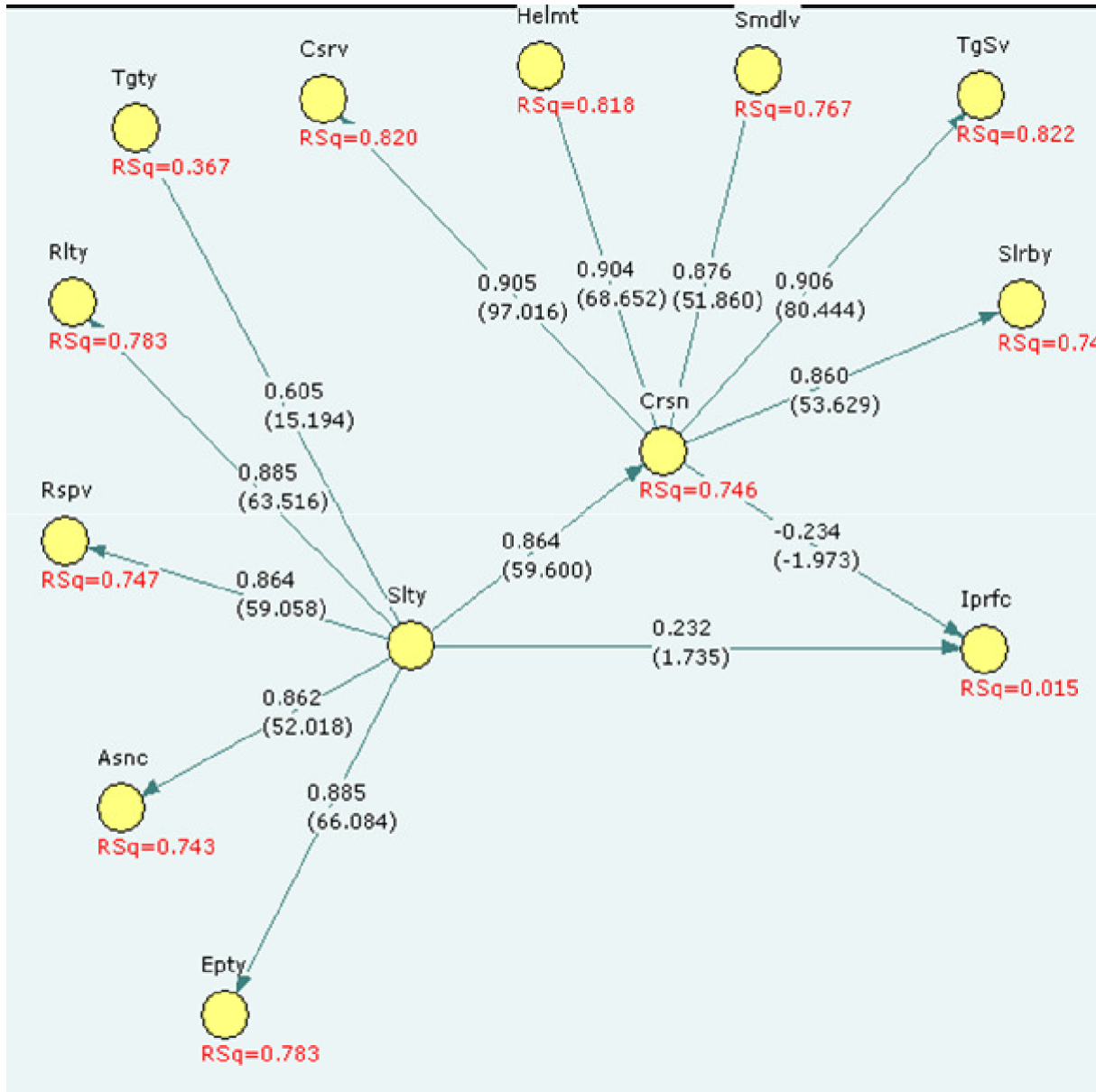
Figure 2. Structural model results-relationship among performance of Islamic bank (Ipfc) in Pakistan. Coefficients, T-values in parenthesis; R^2, (RSq).

service quality (Slty), customer satisfaction (Crsn) and

regression models because it has ability to analyze complicated models in a single and unified process. It examines the influence of relationships on cause-effect paths by considering numerous variables (Gefan et al., 2000).

RESULTS AND DISCUSSION

This study used partial least square (PLS) based structural equation modeling (SEM) to investigate the relationships among service quality, customer satisfaction and bank performance in Pakistan. SEM is a second-generation tool for data analysis based on LIZRAL and

PLS. It is used by researchers to examine the significance of association among different variables as a major SEM technique. It reflects complex relationships of variables regarding the whole model in a meaningful fashion (Hanushek and Jackson, 1977). The results are presented in Figure 2.

The results of the PLS structural models are presented in Figure 2. The PLS structural model indicates coefficients, t-values and R^2, while the standardized coefficients reflect the relative strength of the statistical relationships. It helps to estimate t-values for the constructs and variables under study. Similarly, R^2 is used

Table 1. Summary of the relationship among Slty, CrSn and Ipfc based on PLS results.

Link	Coefficients	T-values	R^2
Slty->Crsn	0.864	59.600	0.746
CrSn-> Iprf	-0.234	-1.9373	0.015
Slty->IPRF	0.232	1.735	0.015

to examine the significance of relationships among service quality, customer satisfaction and bank performance. The coefficients are shown in Table 1.

Table 1 shows the relationship between the constructs and variables of the study. It reflects the coefficients, t-values and R^2 for service quality, customer satisfaction and performance of Islamic banks. There is a strong positive relationship between service quality and customer satisfaction, while weak relationship is observed between service quality and performance of Islamic banks. The results are in line with the previous studies as strong positive relationship is reported between service quality and customer satisfaction among customers of Islamic banks in Pakistan (Ahmad et al., 2010). Interestingly, a weak negative relationship is found between customer satisfaction and bank performance. The results show that service quality significantly affects customer satisfaction as shown by path coefficients in the structural model of Figure 2, but customer satisfaction does not affect the performance of the Islamic banks that is evident from path coefficients. So, the results reject the null hypothesis because customer satisfaction does not mediate the relationship between service quality and performance of Islamic banks.

The results are consistent with the existing literature as PLS is applied by researchers as an effective estimation procedure across the globe (Maikranz et al., 2007). It helps to estimate the relationship among variables and constructs by producing path coefficients (Fu, 2006). Path coefficients are used to estimate the mediating role of customer satisfaction regarding selected variables (Moutinho and Smith, 2000; Maxham and Netemeyer, 2003) and the mediating role of customer satisfaction with reference to service quality and financial performance of the banks (Al-Hawari and Ward, 2006).

It is found that there is weak positive relationship between service quality and customer satisfaction regarding Islamic banks. Interestingly, it is found that there is weak negative relationship between customer satisfaction and performance of the Islamic banks. It identified the gap prevailing in the Pakistani banking sector towards lack of customer orientation and awareness among bank customers. It could be linked with the findings that customers of Islamic banks have awareness, but showed dissatisfaction regarding some of the products of Islamic banks (Naser et al., 1999).

The findings showed that customer satisfaction does not mediate between service quality and bank performance in the case of Islamic banks due to lack of customer orientation and awareness campaigns. The path coefficients of the structural model (Figure 2) represents that customer satisfaction does not play a mediating role between service quality and performance of Islamic banks. It is consistent with literature as customer satisfaction does not mediate between service quality and tangible aspects of the service environment (Jamal and Naser, 2002). It is also supported by other studies (Maxham, 2003; Bontis et al., 2007).

CONCLUSION

The inception of Islamic banking practices in Pakistan documented a success story. Islamic banks got popularity among masses with the passage of time. This study investigated the relationship among service quality, customer satisfaction and performance of Islamic banks. The study identified significant positive impact of service quality on customer satisfaction, but a gap was identified between customer satisfaction and performance of Islamic banks. The gap between customer satisfaction and performance of Islamic banks may be due to the lack of customer orientation. Islamic banks are more concerned towards the expansion of their branch network instead of customer orientation. The results of the proposed model reflect that customer satisfaction does not play the mediating role between service quality and performance of Islamic banks.

It is concluded that managers should improve the quality of services to retain their customers as satisfied customers for long-term benefits. Similarly, they should make arrangements to enhance awareness among customers and employees of banks for improvement of their products/services to enhance performance. Islamic banks should develop marketable products according to Islamic instructions to compete with conventional banks. The study could enhance understanding about the relationship among service quality, customer satisfaction and bank performance regarding Islamic bank in Pakistan.

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