

# Customer Expectations and Perceptions of Service Quality in Islamic Banking: Evidence from Malaysia

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## Abstract

*The aim of this study is to examine the service quality from the perspective of bank customers. This study adopted service quality model called CARTER as proposed by Othman and Owen (2001) to measure service quality in Islamic banking in Malaysia. The original model is based on thirty four attributes under six dimensions; compliance, tangibility, reliability, responsiveness, assurance and empathy. Using factor analysis, twenty attributes were finally chosen. A descriptive statistics analysis (mean and paired t-test) was used to measure customer service quality. The Expectation-Service Gap Grid was also used in the data analysis to identify shortfalls under these six dimensions. Our results indicated that, overall, the service quality of Islamic banks fell below customers' expectations. There were ten attributes in Quadrant I and IV with high service gaps that need corrective actions whereas ten attributes in Quadrant II and III can be accorded a lower priority as the service gaps were low.*

## 1. Introduction

Since the 1970s, Islamic banking has emerged as a new reality in the international financial scene. Its philosophies and principles are however, not new, having been outlined in the Holy Qur'an and the Sunnah of Prophet Muhammad (p.b.u.h.) more than 1,400 years ago. The emergence of Islamic banking is often related to the revival of Islam and the desire of Muslims to live all aspects of their live in accordance with the teachings of Islam.

In Malaysia, separate Islamic legislation and banking regulations for Islamic banks, exist side-by-side with those of the conventional banking system. The legal basis for the establishment of Islamic banks was the Islamic Banking Act (IBA), which came

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into effect on 7 April 1983. The IBA provides BNM with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks.

Islamic banking system comprises full-fledged Islamic banks and Islamic windows within the conventional banking institutions (commercial banks, finance companies and merchant banks). At present, there are currently sixteen full-fledged Islamic banks operating in Malaysia (Table 1). The first Islamic bank established in 1983 is Bank Islam Malaysia Berhad (Bank Islam) followed by the second Islamic bank, Bank Muamalat Malaysia Berhad (Bank Muamalat), established in 1999. These banking products and services based on the Shariah concept, offered by both the Islamic banks and conventional banks marked the beginning of a vibrant and comprehensive Islamic banking and conventional banking side by side.

As the Islamic banking industry grows, competition among banks in offering products and services becomes more intense. In addition, customers become more sophisticated and demanding. Therefore the importance of service quality becomes more pressing. Hence, Islamic banks in Malaysia have to think strategically by providing high quality products and services to satisfy their customers. In order for these banks to provide high quality products and services, they first need to investigate the level of customers' perceptions and expectations to their service quality. Through that information, they could then strategically adjust their service quality toward customers' satisfactions.

The purpose of this study is to assess the perceptions of service quality in Islamic banking in Malaysia, from the customers' perspective. The specific objectives of this study are to:

- examine customers' expectations and perceptions towards the quality of services provided by Islamic banks in Malaysia;
- Identify the gap between the customers' expectations and perceptions towards the level of service quality.

The paper is structured as follows. The next section, Section 2 outlines the literature review, while Section 3 details the methodology and data used in the study. Section 4 presents the findings and Section 5 concludes.

## **2. Literature Review**

Many of the studies on service quality have been carried out within the framework of the service quality model (SERVQUAL instrument) developed by extensive research by Parasuraman *et. al.*, (1985, 1988, and 1991). Since then, many researchers have used this 22-item scale to study service quality in different sectors of the services industry (Gounaris *et. al.* 2003; Arasli *et. al.*, 2005). The service quality model was derived from the magnitude and directions of five gaps as follows:

- Gap 1 (Understanding): the difference between consumer expectations and management perceptions of consumer expectations
- Gap 2 (Service standards): the difference between management perceptions of consumer expectations and service quality specifications
- Gap 3 (Service performance): the difference between service quality specifications and the service actually delivered
- Gap 4 (Communications): the difference between service delivery and what is communicated about the service to consumers
- Gap 5 (Service quality): the difference between customer expectations of service quality and customer perceptions of the organization's performance

Gaps 1 to 4 affect the way in which service is delivered and these four gaps lead to Gap 5. Therefore, the extent of Gap 5 depends on the size and direction of these four gaps (Gap 1, Gap 2, Gap 3 and Gap 4).

In the conventional banking industry, the study on service quality has been undertaken for example by Lassar *et. al.*, (2000); Duncan and Elliott, (2002); Jabnoun and Al-Tamimi, (2002); and Arasli *et. al.*, (2005).

Lassar *et. al.* (2000) studied service quality using two major service quality constructs, SERVQUAL and Technical/Functional Quality models to the private banking industry. They found that Technical/Functional Quality-based model of service quality is better suited compared to SERVQUAL-based model. On the other hand, Duncan and Elliot (2002) explored the relationship between customer service quality and financial performance in Australian banks and credit unions. They found that there was significant relationship between financial performance and customer service quality scores.

Jabnoun and Al-Tamimi (2002) examined service quality at UAE commercial banks using SERVQUAL model and included thirty attributes in the five dimensions of SERVQUAL. When they tested the developed instrument for reliability and validity, they found that the instrument had only three dimensions.

Finally, Arasli *et. al.* (2005) studied service quality perceptions of Greek Cypriot bank customers using SERVQUAL model. They however, extend the study by looking at the relationship between service quality, customer satisfaction and positive word of mouth. They found that the expectations of bank customers were not met where the largest gap was obtained in the responsiveness-empathy dimension. In addition, the reliability attributes had the highest effect on customer satisfaction, which in turn had a statistically significant impact on the positive word of mouth.

In Islamic banking study, Othman and Owen (2001) adopted a model known as CARTER model to study customer service quality. They proposed six dimensions; Compliance, Assurance, Reliability, Tangibles, Empathy and Responsiveness. 34 attributes were included in these six dimensions. Their study focused on Kuwait Finance House and found that the CARTER model to measure SQ in the Islamic banking industry was valid.

### **3. Methodology and Data**

The questionnaire used in this study was adopted from the work of Othman and Owen (2001). It comprised of three parts: Part 1 contains expectations (E) and Part 2 consists of Perceptions (P) of respondents according to the six dimensions listed. These are compliance, tangibility, reliability, responsiveness, assurance and empathy. A five-point likert scale ranging from strongly disagree = 1 to strongly agree = 5 was used to measure the 26 attributes. Part 3 contains questions regarding personal profiles of respondents which include gender, marital status, occupation and income. Gap scores were calculated by subtracting expectations (E) from perceptions (P) of bank customers. The basic assumption underlying the SERVQUAL scale is that performance below expectation (obtaining a negative score) leads to a perception of low SQ, while exceeding expectation (obtaining a positive score) leads to a perception of high SQ.

Respondents used were retail customers of two Islamic banks (Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad) in the East Coast of Malaysia. 200 questionnaires were distributed and 137 were finally useable for analysis. The sample consisted of 54 percent male and 46 percent female. Of the respondents, 46 percent were single, 44.5 percent were married and 9.5 percent were divorced. About 50 percent were in the age range between 20 – 29 years old, 27.7 percent between 30 – 39 years old, 18 percent between 40 – 49 years old and the remainder were age 50 and above. In terms of education, 70 percent of the respondents had a University degree while the remainder with primary or secondary education. 66 percent earned between RM24K and less while the remainder earned more than RM24K per year.

### **4. Findings**

#### ***4.1 Scale purification and its internal consistency***

Using SPSS, we conducted exploratory factor analysis for 26 attributes out of the original 34 attributes as suggested by Othman and Owen (2001). The main purpose is to assess the degree of which attributes are tapping in the same category. Six attributes were deleted as the factor loading values were  $\leq 0.59$ . These attributes were attribute 8 (materials associated with the service are visually appealing), 9 (staff

keeping promise), 18 (behaviors of staff instill confidence in customers), 21 (staff having knowledge to answer questions), 23 (convenient operating hours) and 24 (staff giving customers best interest at heart).

Table 2 shows the results of the scale purification and internal consistency. The Kaiser-Meyer Olkin measure of sampling adequacy is 0.88 and the Bartlett's tests of sphericity is 2216.37 and significant at  $<0.01$ , provide an acceptable adequacy of using factor analysis. The overall alpha coefficient is 0.95.

For the purpose of this study therefore, service quality analysis is based on the remaining 20 attributes.

#### **4.2 Analysis of SERVQUAL Score of the 20 Paired Attributes**

This analysis is done in order to measure the gap between the customers' expectations and their perceptions toward the quality of service in Islamic banks. The means for the perception, expectation, and SERVQUAL score (gap score) are obtained for each statements/attributes and the results are presented in Table 3.

The gap scores with the minus sign mean that customers felt that the service quality of Islamic banks is below their expectations.

Based on the results depicted in Table 3, a comparison of customers' actual perceptions of service quality with their expectations, using the paired *t*-test, indicated a statistically significant difference on all the 20 attributes examined. All attributes had negative mean scores indicating that customers rated service quality of Islamic banks as below their expectations. These imply that Islamic banks need to examine their services and make improvements for any shortfalls.

The biggest gaps were on attributes 14 "staff telling customers exactly when services will be performed" ( $-0.48, p<0.01$ ), 5 "modern-looking equipments" ( $-0.46, p<0.01$ ), 22 "individual attention given by staff" ( $-0.47, p<0.01$ ), 26 "understanding the specific needs of customer" ( $-0.47, p<0.01$ ), 15 "prompt service" ( $p<0.01$ ), 16 "staff willingness to help" ( $-0.46, p<0.01$ ), 10 "sincere interest in solving customers' problems" ( $-0.45, p<0.01$ ), 20 "friendliness and courtesy of staff" ( $-0.45, p<0.01$ ), 12 "provide services at the time they promise to do so" ( $-0.45, p<0.01$ ), and 1 "adherence to Islamic principles" ( $-0.43, p<0.01$ ).

#### **4.3 Grand Mean SERVQUAL Score**

Table 4 shows the grand mean scores and *t*-tests for the six dimensions used in the study. Grand mean scores are calculated on the basis of expectations, perceptions and gap scores for each dimension. The results show that there are significant statistical

differences between expectations and perceptions of these six dimensions as indicated by *t*-tests.

Responsiveness showed the highest gap score (-0.45,  $p < 0.01$ ), followed by reliability (-0.42  $p < 0.01$ ), tangibility (-0.40,  $p < 0.01$ ), empathy (-0.39,  $p < 0.01$ ), and assurance (-0.36,  $p < 0.01$ ). Compliance indicated the least gap score (-0.33,  $p < 0.01$ ). The grand mean score for the overall attributes was -0.40 indicating that the overall service quality provided by Islamic banks in Malaysia fell below customers' expectations. Therefore, Islamic banks need to improve their service quality in order to compete with other banks.

#### **4.4 Expectations-Service Gap Chart**

To illustrate the overall indication of our findings and to identify service shortfalls, we present an expectation-service gap chart in Figure 1. To do this, we plot expectation of Islamic bank customers against the gap scores. The chart is then transformed into a grid as shown in Figure 2, to identify attributes that have serious shortfalls.

The Expectation-Service gap grid is divided into four quadrant; Quadrant I (high expectation and high service gap), Quadrant II (high expectation and low service gap), Quadrant III (low expectation and low service gap), and Quadrant IV (low expectation and high service gap).

Quadrant I and Quadrant IV need immediate attention. There are 5 attributes in Quadrant I and 5 attributes in Quadrant IV. Attributes in Quadrant I are "adherence to Islamic principles", "modern-looking equipments", "sincere interest in solving customers' problems", staff willingness to help", and "friendliness and courtesy of staff". Attributes in Quadrant IV are , "provide services at the time they promise to do so", "staff telling customers exactly when services will be performed", "prompt service", "individual attention given by staff", and "understanding the specific needs of customer". This implies that customers' expectations are not matched by the banks' service performance, leading to high gap scores. The attributes in these two quadrants need corrective actions.

Attributes in Quadrant II and III can be accorded as low priority as the gap scores are low. These attributes are "prompt response from staff", "provide services at the time they promise to do so", insist on error-free records", "neat appearance of staff", "appealing physical facilities", "provision of interest-free products", "provisions of products that are accepted by Islamic law", "customers feel safe in their transactions", "personal attention given", and "provision of profit sharing investments". Even though the gap scores are low, the Banks should also pay attention because if actions are not taken to improve the situations, the gap will soon widen.

## 5. Conclusion

This study was undertaken to examine the expectations and perceptions of service quality from the perspective of Islamic banks' customers.

The result of factor analysis on 26 attributes showed that six attributes were eliminated leaving with only 20 attributes.

The result of gap differences between customers' perceptions and expectations showed that customers' perceptions were consistently lower than their expectations. These negative gaps indicated that the service quality level was unsatisfactory. Accordingly, the biggest gaps related to "staff telling customers exactly when services will be performed", "modern-looking equipments", "individual attention given by staff", "understanding the specific needs of customer", "prompt service", "staff willingness to help", "sincere interest in solving customers' problems", "friendliness and courtesy of staff", "provide services at the time they promise to do so" and, "adherence to Islamic principles".

Using the Expectations-Service Gap Chart and Grid enabled us to identify easily the attributes that need corrective actions. Attributes in Quadrant I and IV need corrective actions whereas attributes in Quadrant II and III were considered a low priority. However, Islamic banks need to narrow these gaps otherwise then gaps will widen and caused negative implications.

The Islamic bank in our opinion should carry out this analysis regularly and make improvement from time to time. Failing to identify and rectify problems will widen the gaps and finally failing to meet customers' expectations more consistently.

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Table 1  
List of Islamic Banks in Malaysia

<b>No</b>	<b>Name</b>	<b>Ownership</b>
1	Affin Islamic Bank Bank Berhad	Local
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Foreign
3	Alliance Islamic Bank Berhad	Foreign
4	AMIslamic Bank Berhad	Local
5	Asian Finance Bank Berhad	Foreign
6	Bank Islam Malaysia Berhad	Local
7	Bank Muamalat Malaysia Berhad	Local
8	CIMB Islamic Bank Berhad	Local
9	EONCAP Islamic Bank Berhad	Local
10	Hong Leong Islamic Bank Berhad	Local
11	HSBC Amanah Malaysia Berhad	Foreign
12	Kuwait Finance House (Malaysia) Berhad	Foreign
13	Maybank Islamic Bank	Local
14	Public Islamic Bank Berhad	Local
15	RHB Islamic Bank Berhad	Local
16	Standard Chartered Saadiq Berhad	Foreign

Source: Bank Negara Malaysia

Table 2  
Results of Factor Analysis

Dimensions/Attributes	Eigen-value	Factor loadings	%age variance	Cum. %age	$\alpha$
<b>Compliance</b>	11.20		43.06	43.06	0.88
1 Adherence to Islamic principles		0.73			
2 Provision of interest free products		0.83			
3 Provisions of products that are accepted by Islamic law		0.76			
4 Provision of profit sharing investments		0.69			
<b>Tangibility</b>	1.14		4.37	64.36	0.76
5 Modern-looking equipments		0.61			
6 Appealing physical facilities		0.65			
7 Neat appearance of staff		0.7			
<b>Reliability</b>	0.75		2.89	77.45	0.85
10 Sincere interest in solving customers' problems		0.68			
11 Staff performing services right the first time		0.73			
12 Provide services at the time they promise to do so		0.66			
13 Insist on error-free records		0.66			
<b>Responsiveness</b>	0.50		1.91	88.44	0.79
14 Staff telling customers exactly when services will be performed		0.65			
15 Prompt service		0.6			
16 Staff willingness to help		0.61			
17 Prompt response from staff		0.61			
<b>Assurance</b>	0.32		1.22	94.13	0.81
19 Customers feel safe in their transactions		0.62			
20 Friendliness and courtesy of staff		0.67			
<b>Empathy</b>	0.22		0.86	97.9	0.83
22 Individual attention given by staff		0.68			
25 Personal attention given		0.68			
26 Understanding the specific needs of customers		0.64			

**Note:** KMO (Keiser-Meyer-Olkin) test of sampling adequacy =0.88, Bartlett's test of sphericity = 2216.37 ( $p<0.01$ ). Overall alpha coefficients ( $\alpha$ ) = 0.95

Table 3  
Expectations, Perceptions, Gap Score and *t*-test Results

Dimensions/Attributes	E	P	G	<i>t</i> -statistic
<b>Compliance</b>				
1. Adherence to Islamic principles	4.61(0.73)	4.18(1.02)	<b>-0.43</b>	4.68 <sup>a</sup>
2. Provision of interest free products	4.47(0.78)	4.14(0.92)	-0.34	3.98 <sup>a</sup>
3. Provisions of products that are accepted by Islamic law	4.43(0.79)	4.10(0.99)	-0.33	3.84 <sup>a</sup>
4. Provision of profit sharing investments	4.36(0.82)	4.12(1.00)	-0.23	2.93 <sup>a</sup>
<b>Tangibility</b>				
5. Modern-looking equipments				
6. Appealing physical facilities	4.28(0.89)	3.81(0.92)	<b>-0.47</b>	4.98 <sup>a</sup>
7. Neat appearance of staff	4.18(0.87)	3.82(0.97)	-0.35	4.24 <sup>a</sup>
<b>Reliability</b>				
10. Sincere interest in solving customers' problems	4.26(0.93)	3.81(0.93)	<b>-0.45</b>	5.46 <sup>a</sup>
11. Staff performing services right the first time	4.20(0.89)	3.81(0.99)	-0.39	3.94 <sup>a</sup>
12. Provide services at the time they promise to do so	4.18(0.86)	3.74(0.93)	<b>-0.45</b>	4.90 <sup>a</sup>
13. Insist on error-free records	4.05(0.93)	3.66(0.91)	-0.39	4.12 <sup>a</sup>
<b>Responsiveness</b>				
14. Staff telling customers exactly when services will be performed	4.23(0.86)	3.75(0.94)	<b>-0.48</b>	5.40 <sup>a</sup>
15. Prompt service				
16. Staff willingness to help				
17. Prompt response from staff	4.23(0.84)	3.76(0.96)	<b>-0.47</b>	4.88 <sup>a</sup>
<b>Assurance</b>				
19. Customers feel safe in their transactions	4.30(0.90)	3.84(0.98)	<b>-0.46</b>	4.93 <sup>a</sup>
20. Friendliness and courtesy of staff	4.04(1.05)	3.65(1.03)	-0.39	3.59 <sup>a</sup>
<b>Empathy</b>				
22. Individual attention given by staff	4.23(0.87)	3.96(0.95)	-0.27	3.06 <sup>a</sup>
25. Personal attention given	4.34(0.87)	3.88(0.99)	<b>-0.45</b>	4.28 <sup>a</sup>
26. Understanding the specific needs of customer	4.12(0.92)	3.65(0.99)	<b>-0.47</b>	5.01 <sup>a</sup>
	3.85(1.18)	3.61(1.03)	-0.23	2.10 <sup>b</sup>
	4.19(0.95)	3.72(1.01)	<b>-0.47</b>	4.70 <sup>a</sup>

Notes: E = Expectations, P = Perceptions, G = Gap score; standard deviations in parentheses;  
<sup>a</sup>  $p < 0.01$ , <sup>b</sup>  $p < 0.05$

Table 4  
Overall Mean Scores and *t*-test Results of SERVQUAL Attributes

SERVQUAL dimensions	E	P	G	<i>t</i> -statistic	Rank
Compliance	4.47 (0.62)	4.14 (0.84)	-0.33	5.06 <sup>a</sup>	6
Tangibility	4.24 (0.73)	3.84 (0.80)	-0.40	5.61 <sup>a</sup>	3
Reliability	4.18 (0.73)	3.76 (0.76)	-0.42	6.01 <sup>a</sup>	2
Responsiveness	4.20 (0.73)	3.75 (0.76)	-0.45	6.25 <sup>a</sup>	1
Assurance	4.28 (0.76)	3.92 (0.84)	-0.36	4.55 <sup>a</sup>	5
Empathy	4.05 (0.82)	3.66 (0.83)	-0.39	5.11 <sup>a</sup>	4
<b>Overall mean</b>	<b>4.24 (0.16)</b>	<b>3.84 (0.17)</b>	<b>-0.40</b>	<b>7.74<sup>a</sup></b>	

Notes: E = expectations, P = perceptions, and G = gap score; standard deviations in parentheses; <sup>a</sup>*p*<0.01, <sup>b</sup>*p*<0.05

Figure 1  
Expectation-Service Gap Chart

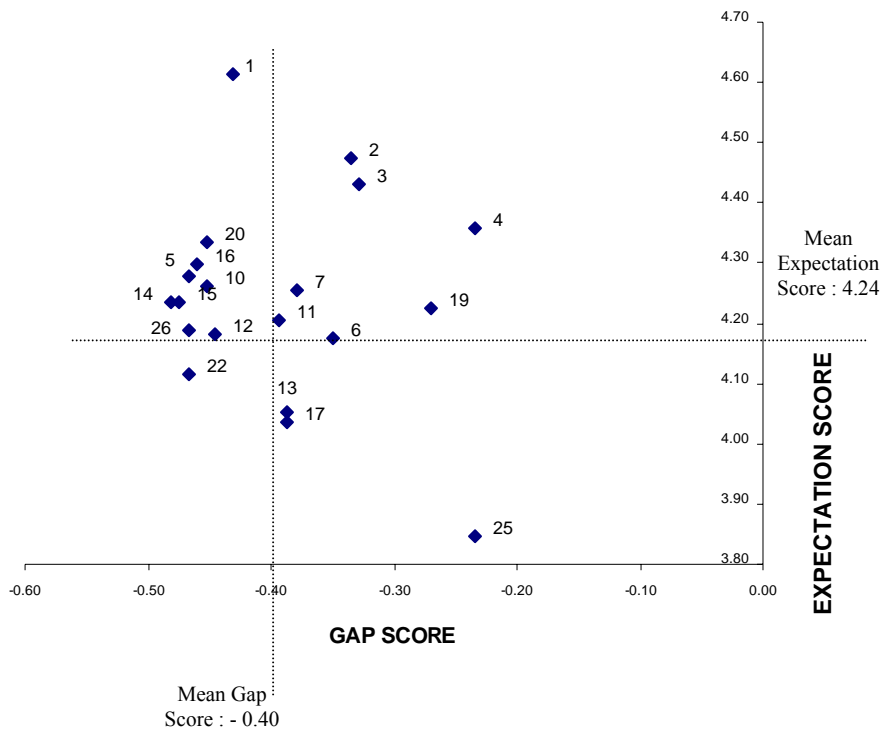


Figure 2  
 Quadrant for Expectation – Service Gap

<p style="text-align: center;"><b>Quadrant I</b></p> <p style="text-align: center;"><i>High expectation and High service gap</i></p> <p style="text-align: center;">Compliance (1) Tangibility (5) Reliability (10) Responsiveness (16) Assurance (20)</p>	<p style="text-align: center;"><b>Quadrant II</b></p> <p style="text-align: center;"><i>High expectation and Low service gap</i></p> <p style="text-align: center;">Compliance (2, 3, 4) Tangibility (7)</p>
<p style="text-align: center;"><b>Quadrant IV</b></p> <p style="text-align: center;"><i>Low expectation and High service gap</i></p> <p style="text-align: center;">Reliability (12) Responsiveness (14, 15) Empathy (22, 26)</p>	<p style="text-align: center;"><b>Quadrant III</b></p> <p style="text-align: center;"><i>Low expectation and Low service gap</i></p> <p style="text-align: center;">Tangibility (6) Reliability (11, 13) Responsiveness (17) Assurance (19) Empathy (25)</p>