Customer Satisfaction and Switching Behavior in Islamic Banking: Evidence from Indonesia

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Abstract

This study is aimed at investigating the dimensions of customer satisfaction in Indonesia Islamic banking industry and how those dimensions could affect the customers' switching behavior. Data collection is done by using self administered questionnaire and involves as many as 732 Islamic bank customers from the area of Jakarta. The methods used in this study are factor analysis and logistic regression model. Factor analysis has successfully uncovered the five dimensions of Indonesia Islamic banking customer satisfaction i.e. profitability, bank staff, accessibility, costs, and bank physical appearance. Afterwards, logistic regression evidences that four dimensions are significantly affecting Islamic bank customers' intention to switch namely bank staff, bank physical appearance, accessibility, and costs. Profitability is perceived less important by respondents with regard to bank-switching issues. **Key words:** Islamic Banking, Customer Satisfaction, Switching Behavior, Indonesia.

The Islamic banking and finance industry is currently at its pinnacle of growth. As at February 2011, total assets of the industry have reached US$1 trillion[2], and according to the report released by the McKinsey & Co. (2008), the industry has recorded an impressive growth rate of 20% to 30% per annum. Obviously, it attracts many conventional banks and financial institutions to also involve in the industry by offering their Islamic windows or subsidiaries to the markets.

In the case of Indonesia, Islamic banking industry has been started since 1992 when the first Islamic bank in Indonesia, Bank Muamalat Indonesia (BMI), was incorporated. It remains the only Islamic commercial bank until 1999 when the government sees that BMI could survive during the 1997/1998 global financial crisis and finally establishes Bank Syariah Mandiri as the government first Islamic bank in Indonesia.

To date, there are 11 Islamic commercial banks with 1215 branches and 23 Islamic windows of conventional banks with 262 branches. The number of Islamic rural banks also increased significantly from 92 in 2006 to 153 in 2011. In total, there are 1,877 branches of Islamic banks spread around Indonesia to meet the needs of Muslims in the country (Table 1). This evidences that Islamic banking market share is growing further in Indonesia.

However, as a consequence of this development, the Islamic banking today is no longer unique. Local as well as foreign banks are setting their Islamic bank units while many rural banks in many districts had transformed themselves

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into Islamic rural banks. Furthermore, conventional banks are also offering similar services by opening their Islamic windows. Thus, in the situation whereby many banks are offering similar services and operate side by side, the competition will become stronger and service quality will be the final judgment for customers to make a decision whether they should remain with current bank or move to other banks for better service quality.

Table 1. Islamic banking development in Indonesia

	1992	1999	2002	2006	2009	2011
Islamic commercial banks	1	2	2	3	6	11
Islamic windows	0	1	6	20	25	23
Islamic rural banks	9	78	83	92	139	153
Number of branches	1	40	127	637	1211	1877

Source: Monthly report of Islamic banking performance in Indonesia (www.bi.go.id)

Therefore, the objectives of this paper are (i) to investigate the service quality dimensions of Islamic banking in Indonesia and (ii) to evaluate the relationship between the customers' level of satisfaction towards the service quality and their switching behavior. In order to have a good presentation, this paper is organized as follow. The immediate section will discuss about the related literatures on customer satisfaction and switching behavior in banking industry and the data and methodology will be discussed in the third section of the paper. Section four discusses the results and discussion and section five reveals the conclusion and suggestion.

Literature Review

Customer Satisfaction in Islamic Banking

Customer satisfaction is a measure of how organization's total product performs in relation to a set of customer requirements (Hill and Alexander, 2006). In the banking industry, as competition increases its level, banks should be more focusing on increasing customer satisfaction and customer retention by improving the service quality level of their banks (Goode and Moutinho, 1996).

Levesque and McDougall (1996) argues that customer satisfaction is essential for retail banks as it has an impact on the organization's profit. Furthermore, in today's competitive environment, providing quality service is an essential strategy for success and survival (Liang and Wang, 2004). In line with this, Trubik and Smith (2000) and Garland (2002) identify direct and strong relationship between customer loyalty and customer profitability in retail banking, while Wisskirchen et al (2006) found that long-term growth and profitability of banks rely on banks' ability to attract and retain loyal customers.

In term of service quality dimensions in the financial services industry, there were various dimensions have been revealed. Parasuraman et al. (1985), for instance, identify 11 dimensions of service quality which are reliability, responsiveness, competence, access, courtesy, communication, credibility, security, competence, understanding the customer, and tangibles. However, based upon their findings, Berry et al. (1985) and Zeithaml and Bitner (1996) indicate that service quality consists of five dimensions which are tangibles (appearance of physical facilities, equipment, personnel, and written materials), reliability (ability to perform the promised service dependably and accurately), responsiveness (willingness to help customers and provide prompt service), assurance (knowledge and courtesy of employees and their ability to inspire trust and confidence), and empathy (caring and individual attention the firm provides its customers).

In the case of Islamic banking, papers attempted to study customer satisfaction upon Islamic banking service quality are still scanty. Among those are papers written by Naser et al (1999), Al-Tamimi and Al-Amiri (2003), Okumuş (2005), Abdul Kader and Norizan (2009), Osman et al (2009), Hossain and Leo (2009), Golmohammadi and Jahandideh (2010) and recently Abduh (2011).

Those studies reveal that customers of Islamic banking are showing considerable degrees of satisfaction and dissatisfaction from many Islamic bank's facilities, services, and products in various countries. The customers are aware of specific Islamic banking products such as murabaha, musharakah, and mudarabah; however, Naser et al. (1999) and Okumuş (2003) find that those customers only deal with some of them. The service quality dimensions uncovered by those studies are similar with what has been done within the conventional banking framework except for Abduh (2011) which recognizes shariah compliant dimension.

In terms of ranking the importance level of the service quality dimensions, many studies from different countries have presented different results. For instance, Al-Tamimi and Al-Amiri (2003) in UAE, Hossain and Leo (2009) and Abdul Kader and Norizan (2009) in Qatar find that tangibles and empathy are the most important dimensions. In Iran, Golmohammadi and Jahandideh (2010) confirms that reliability is the most important dimension and tangible is the least important dimension for Iranian customers. Abduh (2011) verifies that the Islamic banking customers in Indonesia perceivedshariah compliant and convenience as the most important dimensions of Islamic banking.

Customer Switching Behavior in Islamic Banking

Within the conventional banking framework, switching behavior of bank customers is modeled together with perceived value and customer satisfaction. Woodruff (1997) states that perceived value represents customer cognition of the nature of relational exchanges with their service providers, and satisfaction reflects customers' overall feeling derived from the perceived value while Varki and Colgate (2001) shows that customer value impacts customer satisfaction and there is an inter-linkage between perceived service value, customer satisfaction evaluation and intention to switch to other service providers. Similarly, findings from Wang et al. (2004) and Oh (1999) support the direct influence of customer perceived value on customer satisfaction and loyalty towards financial institutions.

In the case of Islamic banking services, Hashim and Latifah (2010) studies the relationship between customer perceived value, relationship quality and switching intention among Islamic banking customers in Malaysia. Using 456 observations, Hashim and Latifah (2010) evidences that customer perceived value significantly influence the level of customer satisfaction which then affecting the intention to switch. The relationship between customer perceived value and the level of customer satisfaction is positive whereas the relationship between the level of customer satisfaction and switching intention is negative.

In Indonesia, Suryani and Chaniago (2011) conducts a field survey towards Islamic bank customers in Surabaya in order to find the switching behavior among the Islamic bank customers. By using exploratory factor analysis, the result indicates that there are five factors that underlying customer switching behavior in Islamic banking services, namely: bank-customer relationship, shariah compliance issues, service quality, switching cost and risk perceived by customers. In addition, discriminant analysis shows that intention to retain is significantly affecting the customers' switching behavior in Islamic banks.

Empirical Methods and Findings

Samples

Data are collected through a direct survey towards 732 respondents within the area of Jakarta-Bogor-Depok of Indonesia. The respondents are all Islamic bank customers. The sample size formula for large unknown population used in this study is adapted from Israel (1992):

$$n_0 = \frac{z^2 pq}{e_2}$$

where:
n0 = Sample size
z = Z-value of α (α in this study is 5%)
p = Variability (variability used in this study is 0.5)
q = 1 - p
e = Level of precision or sampling error (sampling error tolerated in this study is 5%)
therefore, sample size is equal to;

$$n_0 = \frac{z^2 pq}{e_2} = \frac{(1.96)^2 (0.5)(0.5)}{(0.05)^2} = 385$$

Thus, at least 385 respondents should be incorporated in this study. Fortunately, after distributing 1000 questionnaires, this study successfully collects information from 732 respondents which are included in the analysis consisting of 180 (24.6%) female and 552 (75.4%) male. In addition, 432 (59%) respondents are in the age group of 26-35 years while those in the age group of 18-25 and 36-45 years are both 18% of the total respondents. Most of the respondents hold undergraduate degree (55.7%), followed by postgraduate degree (32.8%) and high school (6.6%). Thus, this survey is believed to represent the educated customers with good knowledge in banking, good experience and high frequency of dealing with the Islamic banks.

Table 2. Demography of the Respondents

	Variable	Frequency	Percentage (%)
Gender	Male	552	75.4
	Female	180	24.6
Age (years)	18 – 25	132	18
	26 – 35	432	59
	36 – 45	132	18
	> 45	36	5
Education	High school	48	6.6
	Diploma	36	4.9
	Undergraduate	408	55.7
	Postgraduate	240	32.8
Job type	Government employee	132	18
	Private sectors	312	42.6
	Entrepreneur	156	21.3
	Others	132	18
Job area	Financial institutions	84	11.5
	Education	252	34.4
	Trades	60	8.2
	Others	336	45.9

With regards to their job type, most respondents are working in private sectors (42.6%) and entrepreneurs (21.3%). Those who work as government employee are 132 (21.4%) respondents. In addition, respondents' working area is mostly in the area of education (34.4%) and financial institutions (11.5%) (see Table 2).

Table 3. Service Quality Dimensions Based on Factor Analysis

	Factor/Dimension				
	1	2	3	4	5
Feedbackinformation	.914				
Handling complaint	.838				
Staff attitude	.734				
Staff competencein shariah knowledge	.679				
Female staff attire	.523				
Consumption financing margin		.852			
Homefinancing margin		.805			
Return on deposit		.770			
Returnon saving		.727			
Furniture			.854		
Decoration			.807		
ATM location				.754	
Waiting time in queue				.716	
Internet banking				.645	
Operating hours				.509	
ATMtransaction cost					.766
Cost of services					.679

Note: Extraction Method: Principal Component Analysis; Rotation Method: Varimax with KMO = 0.622 and Bartlett's p-value = 0.000
Factor 1 = Bank staff dimension; Factor 2 = Profitability dimension; Factor 3 = Bank physical appearance;Factor 4 = Accessibility; and Factor 5 = Transaction costs.

Factor Analysis

Factor analysis is applied in this study to identify the fundamental dimensions underlying the original 17 service quality attributes in Indonesian Islamic banking using 0.5 cut point of loading value. Factor 1 incorporates attributes pertaining to feedback information, handling complaint, staff attitude, staff competence in shariah knowledge and female staff attire. Hence, factor 1 can be identified as 'Bank-staff' dimension. Factor 2 seems to suggest a 'profitability' dimension. Attributes loaded to this factor are consumption financing margin, home financing margin, return on deposits and return on saving. Since attributes of furniture and decoration are loaded to factor 3, it clearly depicts the 'bank-physical appearance' dimension. Factor 4 is reflecting the 'accessibility' dimension in Islamic banking industry and it contains attributes such as ATM location, waiting time in queue, internet banking, and operating hours. Lastly, attributes of ATM transaction cost and cost of other services are loaded to factor 5. Hence, factor 5 is likely to reflect the 'cost/charges' dimension (see Table 3).Thus, there are five service quality dimensions revealed for Indonesia Islamic banking industry from this study which are Bank-staff, profitability, bank-physical appearance, accessibility, and costs/charges.

Logistic Regression

Unlike OLS regression, logistic regression does not assume linearity of relationship between the independent variables and the dependent, does not require normally distributed variables, does not assume homoscedasticity, and in general has less stringent requirements (Garson, 2010).

It does, however, require that observations be independent and that the independent variables be linearly related to the logit of the dependent. The predictive success of the logistic regression can be assessed by looking at the classification table, showing correct and incorrect classifications of the dichotomous dependent. The Wald statistic is used to test the significance of individual independent variables.

The odds ratio is defined as the natural log base, e, to the exponent, b, where b is the parameter estimate or abbreviated as Exp(B). For the explanatory variable not included in the equation, b is equal to 0; therefore, the odds that the dependent = 1 is equal to 1. An Exp(B) is greater than 1 implies that the independent variable increases the logit and therefore increases odds(event). If Exp(B) is equal to 1, the independent variable has no effect. And if Exp(b) is less than 1.0, then the independent variable decreases the logit and decreases odds(event). For continuous variables, the odds ratio represents the factor by which the odds change for a one-unit change in the variable.

In this study, the dependent variable is "the intention to switch" when the service cannot meet their expectation with response is equal to "1" for "willing to switch" and "0" for otherwise. The independent variables are the respondent assessments toward the current practices and performances of the service quality dimensions revealed from the previous factor analysis. For example, Bank-staff (1) means that the respondents feel satisfied with its performance while Bank-staff (0) means that they are not satisfied. The detail of the variables used in the logistic regression is in Table 4.

Table 4. Variables in the Analysis

Variable	Value	Interpretation
Dependent Variable		
Has intention to switch	0	No, not willing to switch
	1	Yes, willing to switch
Independent Variable (How customer has perceived below dimensions)		
Bank-staff	0	Poor performance
	1	Good performance
Profitability	0	Poor performance
	1	Good performance
Bank-physical appearance	0	Poor performance
	1	Good performance
Accessibility	0	Poor performance
	1	Good performance
Costs/charges	0	Poor performance
	1	Good performance

Table 5. Classification Table from Logistic Regression

Observed		Predicted		
		Have you ever think to switch bank services?		Percentage Correct
		Never	Yes	
Have you ever think to switch bank services?	Never	12	228	5.0
	Yes	12	480	97.6
Overall Percentage				67.2

Table 5 depicts the classification ability of logistic regression. It shows that 67.2 percent of the respondents are classified correctly. It confirms the mediocre level of the classification ability of the model. The logistic regression model is represented in Table 6. It shows that all independent variables are significantly affecting the decision of Islamic bank customers to switch except for the profitability dimension. The interpretation of the logistic regression output can be done by interpreting the odd-ratio or the Exp(B).

Table 6 explains that customers who perceived that the Bank-staff performance is already good have smaller probability (0.354) to switch the banking service compared to those who say that the bank-staff performance is poor. The same conclusion can be derived for all significant independent variables since all odd-ratio values are smaller than 1. Those who satisfied with the bank-physical appearances like building design and decoration will have smaller likelihood (0.652) to switch compared to those who are not satisfied. Furthermore, the probability to switch for those who perceived that the banks' location is accessible and the costs charged are reasonable are 0.52 and 0.514 respectively and thus they are having smaller probability to switch to other banks compared to those who say that it is difficult to access Islamic banks and those who say that costs charged by Islamic banks are unreasonable.

Table 6. Variables in the Logistic Regression Equation

Variable	B	Wald-statistic	Sig.	Exp(B)
Bank-staff (1)	-1.039	18.141	.000	.354
Profitability (1)	-.200	1.051	.305	.819
Bank-physical appearance (1)	-.428	3.374	.066	.652
Accessibility (1)	-.654	10.952	.001	.520
Costs/charges (1)	-.666	13.621	.000	.514
Constant	2.128	42.796	.000	8.395

The results suggest that Islamic banks in Indonesia should give more attention upon how to adjust and make the costs and charges more competitive, they also need to decide on how to ensure that the people can do banking easily with the banks, and the banks also need to always improve the quality of their staff in giving services and responses to the customers. By doing so, the banks will be able to maintain their current customers and reduce the customers' probability to switch to other financial services institutions.

Conclusion

This study aims to investigate the service quality dimensions in Indonesia Islamic banking industry and explore their relationship with the switching behavior of the Islamic banks customers. The results show that the service quality dimensions in Indonesia Islamic banks are divided into five dimensions which are bank-staff, profitability, bank-physical appearance, accessibility, and costs/charges. However, the profitability is not significantly influencing customers' switching behavior. The factors considered important in the decision process of switching among the Islamic banks customers are bank-staff, bank-physical appearance, accessibility, and costs/charges. Using logistic regression, this study confirms that the better the performance of the Islamic bank services particularly in staff-customer relationship, costs and charges applied and bank accessibility, the lower the likelihood of the customers to switch from those banks.

To improve the discussion and to test the robustness of the findings, further researches are suggested to (i) replicate similar study in other countries and (ii) use different approach and methods to see whether the approach used and the model proposed in this study are robust and applicable.

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