

# The Effect of Religiosity, Service Quality, and Trust on Customer Loyalty in Islamic Banking in Bogor Indonesia

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## Abstract

*The role of Islamic banking in the national economy becomes more strategic as the government is facing fiscal limitation in funding the development. The growth of Islamic banking, a bank managed by implementing the principles of Islamic law, has not been satisfactory. This can be examined by referring to the role of Islamic banking in national banking which is still in the rate of less than 5 percent. This research aims to observe the influences of religiosity and service quality on trust and customer loyalty, as well as to observe the influence of trust on customer loyalty of Islamic Bank in Bogor. By collecting 76 samples of Islamic bank customers in Bogor and utilizing structural equation modeling partial least square (SEM-PLS) as the technique of analysis, it is revealed that the aspects of religiosity and service quality are influential on loyalty if it is supported by trust. Meanwhile, the trust itself has a positive influence on loyalty. The finding implies that to increase the loyalty of Islamic bank customers, customer trust should be built.*

**Key Words:** Islamic Banking, Loyalty, Service Quality, Religiosity, Trust.

## Introduction

The study of World Bank, in 2015, has demonstrated that one of the causes of global financial crisis is a significantly high debt burden. Hence, the level of debt burden eventually results in an impact on low economic growth of a country (Buitier and Rahbari, 2015; Mian and Sufi, 2014). Furthermore, World Bank conveys that "Islamic finance can play a role in improving the stability of the financial sector" (WB, 2015: 1). One of the Islamic financial institutions is Islamic or Sharia Banking. The study of World Bank implicitly indicates that Islamic banking holds an essential role in providing assistance to resolve the global financial crisis.

The role of Islamic Banks in supporting the national economy becomes increasingly strategic due to the fiscal constraints on the government to finance the development. Bank Indonesia has noted that the growth in the number of Islamic banks within the last two decades has increased rapidly. The number of Islamic banks, since the early years of Islamic banking establishment, has now increased to 12 (FSA, 2016). Nevertheless, despite its growth, the contribution of Islamic banks towards the national banking system is still relatively small. Up to August 2016, Islamic banks have only contributed approximately by 5% in the national banking system.

Characteristics of the Islamic banking system, operating on the profit sharing principle, provide an alternative banking system that is mutually beneficial for the community and the bank. The profit sharing principle also highlights the equity aspect in conducting transaction and ethical investment, promoting the solidarity and partnership values in production, and avoiding speculative activities in financial transaction. By offering a range of banking products and services with a more varied financial scheme, Islamic banking becomes an alternative banking system that is credible and can be benefited by every segment of the society.

Meanwhile, the number of Muslim population in Indonesia in 2015 approximately reaches up to 217.2 million people (CBS, 2016). As of December 2015, there are 14.8 million Islamic banking (Islamic bank and Islamic business units) customers. Subsequently, the percentage of Islamic banking customers to the total Muslim population in Indonesia is only 6.8%. Compared with 255.2 million of population in Indonesia, the Islamic bank customers are only 5.2% of the total population in Indonesia. As a country with the majority of Muslim population, low contribution of Islamic banks to the national banks indicates a weak loyalty towards Islamic banks.

As a bank managed by following the Islamic principles of Islamic law, the loyalty to Islamic bank is inseparable from the role of religion, which is in this case, Islam. Metawa and Alomssawi (1998), and Okumus and Genc (2013), researchers of Islamic banks, state that religiosity is a key factor of a customer choosing to use Islamic banking products or services. Although this argument contradicts the notion proposed by Dusiki and Abdullah (2006), stating that religiosity is not an important factor in choosing Islamic banks, Hoq, Sultana, and Amin (2010), in their study of customer loyalty in Malaysian Islamic banking, strengthen Okumus and Genc's argument (2013) stating that it is undeniable that Islamic bank customers become loyal because of their religiosity.

Meanwhile, in their study of loyalty in Malaysian Islamic banking, Hoq, Sultana, and Amin (2010) revealed that customer satisfaction and trust, as well as image, are important factors which determine how a person conducts business in Islamic banks. In conducting business with a bank, the notion of trust is critical to maintain the stability and collaboration in building and sustaining long-term relationships (Sing and Sirdeshmuk, 2000).

The amount of researches on Islamic banks do not provide a commonly acceptable conclusion in relation to the loyalty determinant towards Islamic banks. Consequently, one of the objectives of this study is to conduct hypothesis testing to examine whether religiosity, service quality, and trust affect the customer loyalty in Islamic banking. The findings of this study are expected to strengthen the research results of customer loyalty in Islamic banking.

The research problems are formulated as follow: (1) Does religiosity have an effect on loyalty? (2) Does service quality have an effect on loyalty? (3) Does religiosity have an effect on trust? (4) Does service quality have an effect on trust? (5) Does trust have an effect on the loyalty?

## **Theoretical Framework and Hypothesis**

### **Indonesian Islamic Banking**

Islamic banking development in Indonesia is performed, in the framework of dual-banking system in compliance with Indonesian Banking Architecture (API), to present a complete banking service as an alternative for people in Indonesia. Altogether, the system of Islamic banking and conventional banking synergistically support wider mobilization of public funds to improve funding for the national economic sectors.

According to the Act no. 21 year 2008 concerning Islamic Banking, it is stated that the Islamic Bank conducts its business activities in accordance with Sharia (Islamic) Principles. In reference to its types, Islamic Banking consists of Islamic Commercial Bank and Islamic Rural Bank. Islamic Bank (BS) conducts its business based on Sharia (Islamic) Principles consisting of Islamic Commercial Bank (BUS), Islamic Business Unit (UUS) and Islamic Rural Bank (BPRS);

Islamic principles implement the Islamic law in business activities of fundraising, fund disbursement, and bank services e.g. fulfilling the principles of fairness and balance ('adl wa tawazun). Prosperity (*maslahah*), universalism (*alamiyah*), and containing no *gharar maysir*, usury, unjust and unlawful objects. Further fulfillments of Islamic Principles are presented as follow:

- Fundraising is conducted by implementing *Wadi'ah* and *Mudharabah* agreements;
- Fund disbursement / financing is conducted by implementing *Mudharabah*, *Musharaka*, *Murabaha*, *Salaam*, *Istishna* ', *Ijarah*, *Ijarah muntahiya Bittamluk* and *Qardh*;
- Services is conducted by implementing *Kafalah*, *Hawalah* and *Sharf*.

Furthermore, the Islamic Banking development in Indonesia dated up to January 2016 is presented in the following table.

Table 1 Islamic Banking Development in Indonesia

	December 2014	December 2015	January 2016
Total of Islamic Commercial Bank (BUS)	12	12	12
Total of Islamic Business Unit (UUS)	22	22	22
Total Assets of BUS dan UUS (billion Rp)	272.343	296.262	287.440
Total Assets of Commercial Banks	5.615.150	6.132.583	6.095.908
Contribution of Islamic Banking in National Banking	4,8%	4,8%	4,7%

Source: Islamic Banking Statistics in January 2016 and Financial Service Authority in March 2016

The table shows that the development of Islamic banking is unsatisfactory. This is evident from the number of Islamic banks and Islamic business units which has not increased in recent years, while the assets in Islamic banking fluctuates. The total assets of Islamic banks reached up to 296.262 billion rupiahs in 2014 has increased to 296.262 billion rupiahs in 2015, yet then decreased to 287.440 billion rupiahs in January 2016.

### Loyalty

Loyalty refers to a customer's commitment to remain faithful in using a bank service in a given period of time (Amin, Isa, and Fountain, 2013: 82). A loyal customer will perform: (a) repeat i.e. re-purchase or multiply the savings in the future (share of wallet); (B) retention i.e. unaffected by goods or services offered by other banks; and (c) referrals i.e. recommend positive things to another party (Ladhari et al, 2011; Baumann et al, 2011).

In a business relying on services e.g. banking, loyalty is the key to overcome the competition. Loyal customers will commit to one bank despite any other offers provided by competitors. Furthermore, Oliver (1997) suggests that customer loyalty is a strong customer commitment to re-subscribe or re-purchase the

products/services which are desired consistently in the future times even though the influence of circumstances and marketing efforts has the potential to cause a shifting behavior.

### **Religiosity**

Religiosity is defined as the extent to which religion affects people and their lives in believing in and committing to their religious rituals. Religiosity is an individual appreciation and practice of religious teachings and beliefs, resulting in the notion of faith leading to actions or behaviors. Religiosity or diversity not only occurs when a person commits ritual worship, yet also as the person performs their daily activities.

The effect of religiosity on customer loyalty in Islamic banks has been examined by Metawa and Al-Mosawwi (1998) on Islamic bank customers in Bahrain. They identify that the religiosity is a key factor for customers in deciding to use Islamic bank. This perspective is supported by studies conducted by Bley and Kuehn (2004) studying the Muslim respondents in the United Arab Emirates. Their study reveal that the preference towards Islamic bank is primarily driven by the beliefs of religious teachings.

H1: Religiosity has a significant positive effect on loyalty

### **Service Quality**

Ijaz and Ali (2003), in Aktar and Zaaheer (2014), state that the meaning of service quality will vary from one individual to another. However, it can generally be defined as a notion that meets the consumer expectations, which later becomes a means to retain customers. Most researches in the marketing field focus on the service quality by using service quality (SERVQUAL) model proposed by Parasuraman et al (1985, 1988, 1991) who base on the service quality gaps. The gap arises from the difference between expectations and perceptions i.e. consumer expectations in a management perception on service quality. To measure this gap, SERVQUAL is utilized with its five dimensions i.e. reliability, responsiveness, tangibility, assurance and empathy.

Moreover, other researchers utilize Grönroos' model (1982), proposing the use of three-dimensional service quality measurements i.e. technical quality, functional quality and corporate image. Furthermore, Cronin and Taylor (1992, 1994) introduce a model of service performance (SERVPERF) as a SERVQUAL comparison model. In SERVPERF model, the service quality is measured by the service performance experienced by the consumers, so that they can assess it in accordance with their personal experiences.

Kashif et al (2015) state that the generalization of service quality measurement performed through Servqual is less accurate because the service quality is considered to be more of a cultural phenomenon. Thus, the service quality indicators will be different in other cultures, measuring the service quality by using the same indicators, as cited in a different culture as in Servqual, will provide different applications in different contexts.

Furthermore, Saunders (2008) measures the service quality at the bank in Africa, and proposes the measurement of service quality in the forms of Sincerity (consumer's evaluation of the genuineness of the service personnel); Formality (consumer's evaluation of social distance, form of address and ritual); and Personalization (consumer's evaluation of customization and individualized attention). which later known as PAKSERV. Proper quality services which meet the customer expectations will build customer loyalty due to its capability in maintaining the customer commitment to purchase goods and services in the future times (Butt and Aftab, 2013).

H2: Service Quality has a significant positive effect on loyalty

## Trust

Koufaris dan Sosa (2002:1) define trust as “the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party”.

In a simple manner, trust is a belief that consumer will find what they desire on goods and service providers. Furthermore, Wu and Liu (2007:129) argue that trust is a belief that goods and service providers conduct activities in accordance with the consumer desire.

In the context of Islamic banking, trust is a belief that Islamic banks are implemented by using the Islamic principles, as opposed to conventional banks. Trust is defined as a customer belief in the operations of Islamic banks implemented by the principles of honesty, fairness, and equality (Sultana and Amin, 2010).

The service quality that does not meet the customer expectations will affect the decreasing level of customer trust on goods and service providers. Meanwhile, religiosity as an implementation of the religious teachings also affects the notion of trust that Islamic banks are managed by the Islamic principles of Islamic law. Trust is the determinant factor of loyalty, for the establishment of trust will bring an impact to the customer to remain committed in conducting business with goods and service providers in a long period.

H3: Religiosity has an effect on *trust*

H4: Service quality has an effect on *trust*

H5: *Trust* has an effect on loyalty

## Research Method

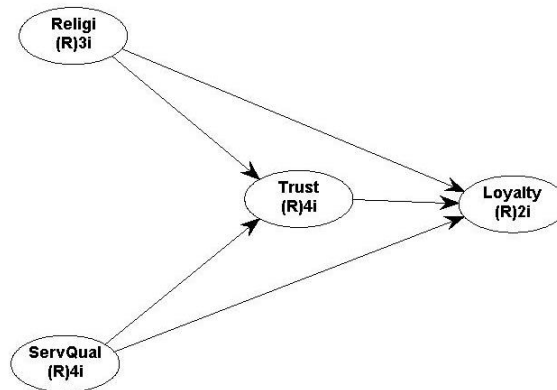
This study is a form of survey by utilizing questionnaires as the instrument. Thus, the study population are Islamic bank customers in Bogor with the minimum criteria of one year saving in Islamic banks. The total samples are 76 customers. This is a causality exploratory study aiming to reveal an explanation in a form of causality (cause effect) between concepts or variables developed in the study by testing the hypothesis.

The technique of data analysis is performed by using Structural Equation Modeling—Partial Least Square (PLS-SEM) Wrap 5.0 developed by Kock (2015). The use of SEM-PLS is caused by latent variables being examined which cannot be measured directly. Besides, the SEM-PLS method does not require a rigid assumption and can be analyzed by using a sample that is relatively not too large.

The construct of religiosity variables will be measured by using three indicators; the construct of service quality variable will be measured by using three indicators; and the construct of trust variable will be measured by using four indicators; and the construct of loyalty variables will be measured by using two indicators.

## Research Model and Hypothesis

The research model of the effect of religiosity, service quality, and trust on customer loyalty in Islamic banking is presented in the figure as follows.



The hypothesis testing examined in this study are:

- H1: Religiosity has a positive effect on loyalty
- H2: Religiosity has a positive effect on trust
- H3: The service quality has a positive effect on trust
- H4: The service quality has a positive effect on loyalty
- H5: Trust has a positive effect on loyalty

## Data Analysis and Discussions

### Validity Test

Validity is the measurement accuracy to function as a legitimate measurement. A validity test on the instrument (indicator) is conducted to measure its legitimation. To examine whether an indicator is valid, criteria of loading factor should be above 0.4 with the loading factor above 0.7 and significant value of <0.05 is preferred (Hair et al, 2015). Validity test results are shown in Table 2 below.

Table 2 Output loading and cross loading

Indicator	Religiosity	ServQual	Trust	Loyalty	P value
Reli1	0,798	-0,025	0,061	0,127	< 0,001
Reli2	0,905	0,360	-0,211	-0,198	< 0,001
Reli3	0,809	-0,267	0,176	0,096	< 0,001
SQ1	0,028	0,849	-0,017	-0,144	< 0,001
SQ2	0,078	0,902	-0,350	0,084	< 0,001
SQ3	0,697	0,804	-0,366	-0,047	< 0,001
SQ5	-0,684	0,740	0,843	0,114	< 0,001
Trust1	0,044	0,426	0,526	-0,220	< 0,001
Trust2	0,796	-0,112	0,791	-0,101	< 0,001
Trust3	-0,107	0,346	0,802	-0,008	< 0,001
Trust4	-0,700	-0,015	0,751	-0,007	< 0,001
Loyal1	0,508	-0,151	-0,352	0,858	< 0,001
Loyal2	-0,508	0,151	0,352	0,858	< 0,001



Influence	Coefficient	P Value	Note
Religiosity → Loyalty	0,04	0,39	Insignificant
Service Quality → Loyalty	0,04	0,36	Insignificant
Religiosity → Trust	0,42	< 0,01	Significant
Service Quality → Trust	0,51	< 0,01	Significant
Trust → Loyalty	0,59	< 0,01	Significant

Table 2 shows that every loading factor of the indicators qualifies the validity requirement. This is strengthened by the loading value to another construct (cross-loading) which is worth less than its construct variable (Hair et al, 2015).

### Reliability Test

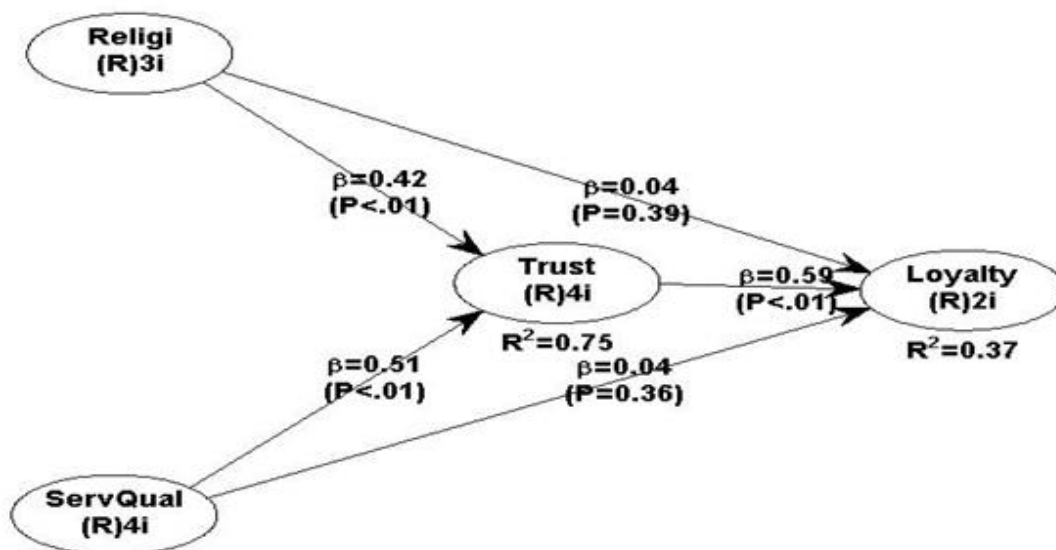
Reliability Test is associated with the consistency of a variable construct. Hair et al (2015: 102) state that the composite reliability by 0.6 to 0.7 is acceptable as a reliability measurement with a value between 0.7 to 0.9 at best. The results of reliability test are presented in Table 3 as follows.

Table 3 Reliability Test

Construct	Composite Reliability
Religiosity	0,877
Service Quality	0,895
Trust	0,651
Loyalty	0,848

Table 3 indicates that all constructs have fulfilled the criteria of reliability.

### Hypothesis Testing



### Hypothesis 1

The effect of religiosity on loyalty coefficient is 0.04 with  $p = 0.39 (> 0.05)$ , indicating that there is insufficient evidence to support hypothesis 1 stating that religiosity has an effect on loyalty. This also demonstrates the insignificant effect of religiosity on loyalty. This finding is contrary to what is revealed by Bley and Kuehn (2004) showing that religiosity has an effect on loyalty. This finding strengthens a study conducted by Bank Indonesia (2001) in West Sumatra. Being asked whether the bank interest is forbidden (haram), 20% of respondents stated that interest is haram, while 39% stated that they do not know/are in doubt, and 41% of respondents stated that the interest is not haram. Meanwhile, the survey conducted by Bogor Agricultural University in South Kalimantan (2004) revealed different finding i.e. 79.3% of respondents stated the bank interest is haram, nonetheless, they remain the users of conventional banks despite believing that the bank interest is haram.

Subsequently, there has been no conclusion whether religiosity has an effect on loyalty. Findings proposed by Amin et al (2013) in their study on Muslims and non-Muslims customer behavior in Malaysia indicate that non-Muslim customers are also loyal to Islamic banks. This shows that religiosity has no effect on customer loyalty in Islamic banks.

### Hypothesis 2

The effect of service quality on loyalty is 0.04 with  $p = 0.36 (> 0.05)$  indicating its positive effect. However, there is an insufficient statistical evidence to support hypothesis 2. Therefore, it can be interpreted that the service quality is unqualified to be a good variable as a loyalty determinant. This notion is contrary to what is presented by Butt and Aftab (2013). The unconfirmed finding that the service quality has an effect on loyalty supports what is conveyed by Kashif et al (2015) stating that service quality is related to the culture. Different cultures will respond differently on the service quality provided by Islamic banks.

### Hypothesis 3

The effect of religiosity on trust is 0.42 with  $p < 0.01 (< 0.05)$  indicating that there is a sufficient evidence to confirm hypothesis 3, stating that the religiosity has a positive effect on trust. This notion also indicates that the more a person embraces diversity and implements it in daily life, the bigger the trust the person has in believing that Islamic bank is managed by following Islamic principles.

This finding strengthens the indication in the previous studies that religiosity represents a person's daily behavior and holds an influence on a belief that his/her action is in accordance with Islamic principles.

### Hipotesis 4

The effect of service quality on trust is 0.51 with  $p < 0.001 (< 0.05)$ , indicating that the service quality significantly has a positive effect on trust. This finding confirms hypothesis 4 in which the service quality has an effect on trust. It also implies that improving the service quality fulfilling the expectation of Islamic bank customers will have an impact on their increasing trust. This is in line with the findings revealed by Rizwan et al (2014) in his study in Pakistan.

### Hypothesis 5

The effect of trust on loyalty is 0.59 with  $p < 0.001 (< 0.05)$ . It shows the significance of trust in affecting the loyalty, and there is sufficient evidence to confirm hypothesis 5 that trust has a positive effect on loyalty. This finding implies that the more one trusts Islamic banking, the more loyal the person becomes.



The effect of trust on loyalty has been studied by some previous scholars; including Hoq, Sultana and Amin (2010); Butt and Aftab (2013) revealing that the notion of trust has a positive effect on loyalty.

## Conclusion

Religiosity holds a positive effect on loyalty, nonetheless, the amount of statistical evidence is insufficient to prove the notion. Meanwhile, the service quality also has a positive effect on loyalty, however, the data have not confirmed the respective influence.

Furthermore, religiosity has a positive effect on trust as it is supported by the data. Improvements on the diversity will increase the trust towards Islamic banks. Service quality has a positive effect on trust which is supported by the data confirming the effect. Hence, it can be concluded that the better the service quality provided by Islamic bank and the more it meets customers' expectations, the more trust can be achieved by the Islamic banks. Meanwhile, trust has a positive effect on loyalty supported by the data in this study to confirm the effect. This indicates that as the customer trust towards Islamic bank increases, the customer loyalty towards Islamic banks increases as well.

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