CHAPTER ONE

INTRODUCTION

Competing financial institutions are much alike in the services they offer. Their prices are comparative, and they often offer comparable convenience of location. They may even look alike. Where they differ is in service. Competing institutions may offer the same services, but they do not offer the same service. Quality of service is the great differentiator; quality of service gets and keeps the customers' attention (Berry, Bennett and Brown 1989, p. 4).

The critical importance of differentiation is not lost on financial institutions today. By and large, their primary means of achieving it has been through market segmentation - identifying key target customer groups, then developing marketing mixes tailored to meet their needs. Although market segmentation does provide a basis for attracting a preferred customer base, it is difficult to develop a stable of products that are distinct in the customer's mind from those offered by competing institutions pursuing the same market segment. Service quality can be extraordinarily important in achieving a distinctive offering (Berry, Bennett and Brown 1989, p. 5).

It has always been difficult to distinguish one institution from another in terms of products and pricing. Products and pricing can be structured and introduced in a matter of days, or, in some cases, hours. Product originality is important but short-lived. Consumers agree that service makes an important difference. According to the 1987 American Banker consumer survey, quality of service is a major factor in winning customer loyalty (Berry, Bennett and Brown 1989, p.5)

Quality service is one of the few ways a financial institution can differentiate itself sufficiently in the marketplace to achieve exceptional business growth and earnings performance. It can help cut costs and boost revenues through relationship broadening, productivity enhancement and error reduction. Therefore, service quality is a key element of profit strategy (Berry, Bennett and Brown, 1989 p. 7).

The connection between quality and profitability has been well established by the Strategic Planning Institute through its Profit Impact of Market Strategies (PIMS). In *The PIMS Principles,* Buzell and Gale (1987) were unequivocal in claiming a relationship between profitability and relative perceived quality. Among the benefits that accrued to businesses offering perceived quality were stronger customer loyalty; more repeat business; reduced vulnerability to price wars; ability to command higher relative price without affecting market share; lower marketing costs; and growth in market share.

This study is a case study on United Malayan Banking Corporation Berhad (UMBC), a locally incorporated commercial Bank, using a research instrument, SERVQUAL, to measure the quality of service at the Bank. SERVQUAL is a multiple item scale that assesses the levels of expectations and perceptions of customers to pinpoint shortfalls in service quality along the five basic dimensions of the scale. The study will attempt to identify specific areas where shortfalls exist, both on an overall basis and along each of the five service quality dimensions. The demographic of the customers will also be used to examine differences in perception between segments.

Services Sector in Malaysia

Service quality has become a major issue in economies where services contribute towards a large part of the Gross National Product and are responsible for creating a majority of jobs in the economy. Therefore it has become necessary to monitor the levels of service quality which has led researchers to focus on methods to assess service quality objectively (Ashok 1992).

Services are necessary for the economy as they facilitate economic activities within the country and also the flow of international trade in merchandise. A strong services sector contributes to national wealth and can also be a source for export. At present, there is a net outflow from Malaysia for the purchases of various services such as transportation, insurance and consultancy services, which is evident from the persistent deficit in the services account of the Balance of Payments. In addition, there are outflows of profits and dividends arising from foreign investment in industries in the country (Economic Report 1993).

In light of these developments, the thrust of strategies for the services sector is aimed at enhancing the quality and quantum of services produced within the country and promoting services as exports to foreign markets. Strategies for the services sector are being formulated and coordinated by the Cabinet Committee on Services chaired by the Honourable Prime Minister, Dr Mahathir Mohamed (Economic Report 1993).

The services sector in Malaysia comprises wholesale and retail trade, hotel and restaurants, finance, insurance, real estate, business services, transport, storage and communications, government service, electricity, gas and water sub-sectors. For 1993, the share of the services sub-sector to GDP was anticipated to increase to 44.1% from 43.8% in 1992. The services sector was expected to register a moderate expansion of 8.7% in 1993 compared with 9% achieved in 1992. The moderation in growth is in tandem with the slower expansion of the other sectors of the economy, particularly agriculture and mining. However, despite the moderation, growth in the various sub-sectors, with the exception of government service, was expected to outpace overall GDP growth (Economic Report 1993).

The services sector is the single largest employer, accounting for 46.7% of the total employed labour force in 1993 (Economic Report 1993). As in preceding years, the financial services and distributive trade sub-sectors is expected to provide the stimulus to the relatively high growth rate for the sector as a whole. The finance, insurance, real estate and business services sub-sector's share in both real GDP at 10.6% and the services sector as a whole at 24.1% was expected to remain significant (Economic Report 1993).

The Uruguay Round of negotiations on service trade which concluded in April 1994 and came into force in the World Trade Organisation on January 1995, is expected to pose new challenges to the services industry, particularly with regard to liberalisation and potential competition from abroad. In view of this, the domestic services industry has to be strengthened. Local services suppliers should increase their levels of efficiency and productivity, particularly in areas where such services are provided from abroad. The market in services is dominated by foreign suppliers and when liberalisation does take place, local suppliers may not be able to compete with the foreign suppliers from the developed nations. There is, therefore, a need to identify strategies that can promote a stronger local services industry so that the economy will benefit from greater local participation (Economic Report 1993).

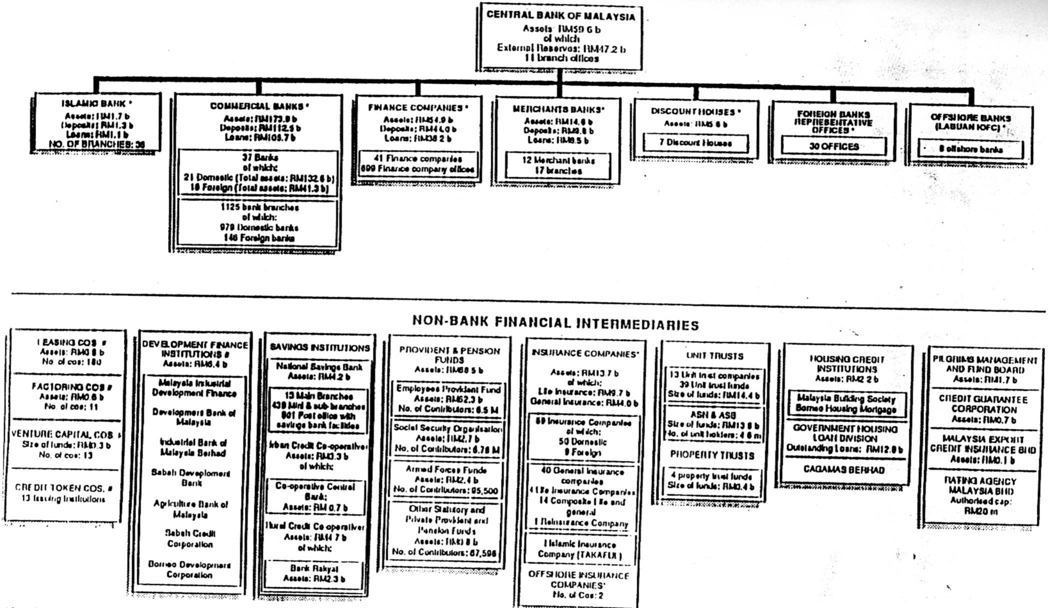
Commercial Banks in Malaysia

The Malaysian financial system can be divided broadly into banking institutions and non-financial intermediaries as shown in Figure 1.1. The banking institutions include commercial banks, finance companies, merchant banks, money and foreign exchange brokers.

The commercial banks are the largest and most important group of financial institutions in Malaysia. Their importance stems mainly from their provision of current account facilities. Commercial banks account for nearly 75% of the total deposits placed with the financial system and 65% of the total credit extended to the private sector (Bank Negara Malaysia Annual Report 1987).

The activities of commercial banks have expanded significantly in the past three decades. Total bank resources, which amounted to a mere RM1,232 million in 1960, or one-third of the total resources of the entire financial system, increased to RM86,000 million at the end of 1987, equivalent to about 42% of the total resources of the Malaysian financial system (Bank Negara Malaysia, Annual Report 1987, p.70-71). In the 1960s, total resources of the commercial banks increased at an average annual rate of 14.2%. However, in the 1970s and 1980s, growth rate accelerated to an average of 22% per annum.

FIGURE 1.1
THE FINANCIAL SYSTEM STRUCTURE
As at December 31, 1992
THE BANKING INSTITUTIONS



* Supervised by the Central Bank
# Registered with the Central Bank

The rapid growth in resources was due mainly to the increase in deposits placed with commercial banks, which accounted for 70% of the total increase in their new resources (Bank Negara Malaysia, Money and Banking in Malaysia, 1984, p. 162).

Background on UMBC

UMBC was the third largest bank in terms of asset size among Malaysia's twenty-three locally incorporated banks with an asset size of RM14.3 billion as at end of January 1991. However, UMBC has since slipped to the fourth position. One of the main reasons for the deterioration was the bank's substantial bad and doubtful loans portfolio as a result of the recessionary periods between 1985 and 1988 (Star 6 April 1992). Another contributing factor may have been the liberalisation of interest rates by Bank Negara Malaysia which intensified competition among financial institutions in Malaysia.

Founded in 1960, UMBC has had an often controversial and financially troubled history as ownership of the institution changed hands several times and heavy losses battered the bank since 1985 - 1986 recession, the worst in Malaysia's history (Asian Wall Street Journal 15 - 16 July 1994). In 1984 Tun Daim had acquired 40.7% interest in UMBC from Multi-Purpose Holdings Bhd in exchange for shares in, then Daim-controlled, Malaysian French Bank. In 1985, Tun Daim controlling stake in UMBC had provoked controversy because the acquisition went through without public disclosure, well after Tun Daim became Finance Minister in July 1984 (Asian Wall Street Journal 22 July 1991).

Following a cabinet decision requiring ministers to divest their holdings in business, Tun Daim arranged to sell his family's stake in UMBC to Pernas, a state-owned company. Pernas took a big Yen-denominated loan in 1986 to acquire 50.38% of UMBC divested by Tun Daim (Pernas prior to the acquisition held 32% of the bank). The loan became a burden for Pernas when the Japanese currency later appreciated sharply against the Ringgit, making it increasingly difficult for Pernas to meet interest payments (Asian Wall Street Journal 22 July 1991). Pernas was also not happy with UMBC's low dividend yield. The bank paid a gross dividend of about 1% a year, while Pernas financing charges was 6% (Business Times 2 August 1991).

In mid-1993 Datuk Keramat and Datuk Mohamed Noor Yusof, the company's controlling shareholders, emerged as UMBC's latest owners after acquiring 60% stake in the bank for RM600 million from Pernas. Since then, the institution's revamped management and more stringent credit controls have put the bank on a sounder financial footing (Asian Wall Street Journal 15 - 16 July 1994).

UMBC's profitability has shown improvement since 1992 (Table 1.1). Return on Shareholders' Funds (ROSF) has improved from 1.0% in 1991 to 9.4% in 1992 and 12.5% in 1993. Return on Assets (ROA) has also increased from 0.05% in 1991 to 0.49% in 1992 and 0.56% in 1993. However, despite improvement in profitability, UMBC continues to lose market share (Table 1.2).

<u>**Table 1.1 : Profitability of UMBC**</u>

	1989	1990	1991	1992	1993
Pre-Tax Profit (RM mil)	16	22	5	49	68
ROSF	3.2%	4.3%	1.0%	9.4%	12.5%
ROA	0.23%	0.27%	0.05%	0.49%	0.56%

<u>**Table 1.2 : UMBC's Market Share**</u>

	1989	1990	1991	1992	1993
Loans	7.0%	7.1%	7.5%	5.4%	5.0%
Deposit	7.2%	7.1%	7.5%	6.5%	5.3%
Asset	8.0%	6.3%	6.4%	5.7%	5.4%
Total Income	10.%	NA	6.9%	5.7%	5.1%

Objectives of Study

The primary focus of this study is to measure the level of service quality at United Malayan Banking Corporation Berhad (UMBC) by studying the perceptions and expectations of its customers. The objectives of the study are as follows:

1. To assess the overall level of service quality at United Malayan Banking Corporation Berhad (UMBC) as perceived by its customers.

2. To identify the dimensions of service quality of UMBC.

3. To determine the relative importance of the dimensions identified in influencing the overall service quality of UMBC as perceived by its customers.

In addition to the above, the demographic variables of the customers will also be used to study the differences in perception in regard to several aspects and dimensions of service quality. The effect of demographic variables on service quality will also be examined.

Significance of Study

The findings and recommendations made will have important managerial implications to direct efforts to improve the level of service quality by bridging the service quality gap resulting from the differences between expectations and perceptions of customers.

In bridging the gap, it is hoped that the UMBC will improve its profitability by reducing high costs associated with poor service, such as loss of market share, high cost of service errors, high marketing costs, and low product pricing.

Scope of Study

This study is confined to customers of UMBC in the Kuala Lumpur area. The study does not extend to non-customers of UMBC to find out their perceptions of the quality of service of the Bank which may have deterred them to patronise the Bank.

Customers of the Bank in this study refers to individuals or individuals whose companies are enjoying any type of facilities, either deposits or credit facilities with the Bank.

Limitations

Among the limitations which the study were subjected to were the sample used, the survey instrument and scope of the study itself.

The sample size of 169 respondents may not be representative of the population. Moreover, due to time constraints, the sample was confined to customers from six branches in the Kuala Lumpur area and departments in the Head Office. About 36 of 21% of the respondents were staff of UMBC. As such, the findings of this study can only be used as a guide for the management of UMBC to further investigate the reasons for the shortfalls in service quality.

Another limitation of this study was the survey instrument itself. This study used the multi-item scale used by Lim (1992) based on the original SERVQUAL scale developed by Parasuraman et al. (1988a). Three pairs of the original SERVQUAL instrument had been excluded from the adapted scale used by Lim (1992), due to duplication of meanings and to make the SERVQUAL instrument more relevant to the local context. Since the scale was basically the same scale used in Lim's (1992) study with the exception of an additional section being incorporated into the scale taken from the scale used by Parasuraman et al. (1991) which is a refined version of the earlier scale developed by Parasuraman et al. (1988a), no pre-testing had been done on the modified instrument. The absence of the pre-testing may have affected the respondents' understanding of the items in the questionnaire. Moreover, respondents may have different interpretations of the statements due to the different level of competency in the command of language and the level of education.

Another area of concern was the fact that the SERVQUAL scale used for this study had less than 20 items. In instances where the number of variables are less than 20, there is a tendency for the factor analysis, using the latent root criterion, to extract a conservative number of factors. Furthermore, the original SERVQUAL scale was developed in the United States and across five different service categories.

The aim of the study was to apply the SERVQUAL instrument to assess the service quality of a local commercial bank. The study was not meant to validate the SERVQUAL instrument.

Organization of Study

This study comprises five chapters. Chapter 1 serves as an introduction to the study. It discusses the importance of service quality in financial institutions, the service sector in Malaysia, commercial banks in Malaysia, and background on UMBC. This chapter presents to the reader the objective of the study, the significance of the study, its scope, and limitations.

Chapter 2 comprises several sections. The chapter begins with the definition of services, and financial services. It then gives a conceptualization of quality, perceived quality, and service quality. Lastly, the chapter reviews literature on past studies done in the area of service quality.

Chapter 3 outlines the research methodology. This chapter describes the general approach of the research design, questionnaire design, the sampling plan, data collection procedures, and the statistical techniques used to analyse the data.

Chapter 4 analyses the research results. It examines the dimensions of service quality and the importance of these dimensions in influencing overall perceived service quality.

Chapter 5 summarises the research findings and makes recommendations for improvement of service quality. This chapter also makes recommendations for future research.