

CHAPTER 1

INTRODUCTION

Chapter 1 introduces the structure and content of the thesis. The issue of relationship marketing is highlighted and in particular, the significance of switching intentions on the part of Islamic banking customers is discussed. The chapter commences with the background study followed by an overview of Islamic banking and its development in Malaysia. The research problem is consequently defined, followed by the research questions and research objectives. The significance of the study is then presented and the chapter finishes by outlining the organization of the whole thesis.

1.1 Background of the Study

In the context of retail banking, an exchange takes place involving people and processes. It is within these elements that a customer's evaluation of organizations is created and future behavioral intentions are determined. The nature of the financial services industry is such that it involves selling highly competitive and intangible services in near-saturated markets.

The economic advantages associated with retaining existing customers as opposed to recruiting new ones have drawn academicians and practitioners to pay greater attention to relationship marketing (Anderson et al, 1993; Ndubisi, 2007). Although the concept of relationships is highly subjective, it may be useful to explore various dimensions of a relationship and address their influence on behavioral outcomes.

The robust growth of conventional and Islamic banking systems in Malaysia has afforded customers greater choices in banking products and financial service providers. Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Shariah) and its practical application through the development of Islamic economic thought. Shariah is distinguished by its prohibition of the payment or acceptance of interest for the lending and receipt of monies as well as investments in businesses that provide goods or services considered contrary to its principles.

Unlike conventional banks, Islamic banking transactions must comply with Islamic Shariah laws and principles (Siddiqui, 1992). Furthermore, the basic tenet of Islamic banking is the sharing of profit and loss and the prohibition of *Riba* (usury). At a time when Islamic banking faces intensifying inter and intra competition, its service providers are challenged with the demands of savvy, well-informed, value-conscious customers expecting sophisticated and competitive financial solutions.

As competition intensifies amongst financial service providers, close relationships have come to be regarded as a key asset and have gained increased prominence in many service firms (Chen et al, 2008). The popularity of relationship marketing stems, in part from the assumption that building customer relationships will lead to increased benefits for the organization. Some of the derived benefits include customer satisfaction, increased loyalty, positive word of mouth and increased purchases from customers.

In a similar context, organizations need to build and enhance customer relationships that deliver value beyond that provided by the core product. Past studies in the banking environment show service quality to be a critical measure of organizational performance and remains at the forefront of many service marketing literature and practice (Lassar et al, 2000). The delivery of high quality services is a must for attaining customer satisfaction and other desirable behavioral outcomes.

However, it has been shown that the relationship between satisfaction and loyalty is neither linear nor simple (Jones and Sasser, 1995). Satisfied customers have also been known to defect and within a banking context the reasons are not so clear (Bloemer et al, 2002). Although service failures and dissatisfaction represent some of the reasons that customers switch services, they do not account for all of them (Keaveney, 1995).

Time or money factors, lack of alternatives, switching costs, habits, convenience and price may affect behavioral intentions (Bitner, 1990; Cronin and Taylor, 1992). By its very nature, the consumer's evaluation of a retail bank is a complex process and further examination may enhance understanding of how such customers come to decide whether to stay or switch service providers.

Despite the recognition of relationship marketing as an important strategy, it is not necessarily effective and profitable for every segment, thus making it crucial for financial service providers to know which groups of customers share common values and expectations.

Whether the objective is acquiring or retaining customers, a customer relationship marketing strategy is deemed important in the financial services industry (Liang and Wang, 2006).

1.2 Overview of Islamic banking

In the last thirty years, the Islamic financial services industry has undergone robust expansion in various countries around the world and has now evolved into being part of the mainstream financial landscape. Islamic banks are representative of a new wave of corporations whose social goals are at least (if not more) as important as making profit (Haniffa and Hudaib, 2007). Based on the definition by Gray and Balmer (2001), such corporations incorporate what they described as an ‘ethical identity’.

Islamic banks perform the same functions of any conventional bank but in adherence to Shariah laws or Islamic rules and principles (Siddiqui, 1992). Some of the salient features of Islamic banking include the need to strive for a just, fair and balanced society as envisioned by the Islamic economic thought (Mirakhor, 2000).

Amongst others, the absolute prohibitions on interest, gambling and excessive risks among others, are to protect the interests and benefits of all parties involved in market transactions and to promote social harmony (Ahmad, 2000; Chapra, 2000). Unlike the capitalist system, Islamic banking is constructed upon the principles of brotherhood and cooperation which stands for a system of equity sharing, risk sharing and stake sharing (Dusuki and Abdullah, 2007).

It is estimated that there are over three hundred Islamic financial institutions worldwide. The world's 100 largest Islamic banks have set an annual growth rate of 26.7% and the global Islamic finance industry is experiencing average growth rate of 15%-20% annually (Bank Negara Malaysia Annual Report, 2007). The continued growth of Islamic banking may be attributed to the increasing demand from a large number of Muslims for financial services that are Shariah-compliant and the attractiveness of such services to non-Muslim investors seeking "ethical" investments.

1.3 Islamic banking in Malaysia

Malaysia's Islamic banking has been in existence for over thirty years. The enactment of the Islamic Banking Act 1983 enabled the country's first Islamic Bank to be established, Bank Islam Malaysia Berhad (BIMB). After almost three decades, today there are seventeen full fledged Islamic banks, eleven of which are Malaysian owned whilst six are foreign-owned banks offering Islamic banking services and products (Bank Negara Malaysia, 2008). Presently, Malaysia's Islamic banking assets reached USD65.6 billion with an average annual growth rate of 18%-20% (Bank Negara Malaysia Annual Banking Statistics, 2007).

Liberalization efforts by the Malaysian government has allowed for foreign equity participation of up to 49% for Islamic banking and Islamic insurance or *takaful*. Accordingly, the presence of key foreign Islamic financial institutions operating side by side with home grown banks has enhanced Malaysia's reputation as an Islamic financial services hub.

The greater number of players in the marketplace competing for the same customers requires strategic actions to be taken by financial service providers to guarantee the survival of their financial institutions. Islamic banks must not rely on solely religious factors as a strategy to secure customers' loyalty but they should also emphasize providing quality and efficient products and services (Dusuki and Abdullah, 2007).

Liang and Wang (2006) also acknowledge that for financial service providers, service quality enhancement and relationship marketing strategies are appropriate strategic tools to be used in the competitive financial services landscape (Liang and Wang, 2006).

1.4 Research Problem

The liberalization of financial service providers and new forms of technology has impacted customer behavior. Customers are now well disposed to changing their buying behavior and switching financial service providers more often. This makes financial service providers less certain of customers' loyalty.

Furthermore, intense competition among banks in Malaysia offering Islamic banking services means that Islamic banking financial service providers needs to be creative especially in developing and building collaborative relationships with their customers. As in many other service businesses, the intangibility of the service offerings in the banking sector highlights the importance of customer relationships. This has seen considerable attention drawn to the concept of relationships between service providers and their customers (Wong and Sohal, 2004; Reynolds and Arnold, 2000).

This study adopts the relationship approach from the relationship marketing perspective with the aim of providing an objective and professional assessment whether relationship quality can explain and predict behavioral intention besides the commonly used service quality measures.

Relationship quality plays a critical role in the study of long-term relationship maintenance (Finn, 2005) and relationship quality has been found to influence behavioral outcomes (Roberts et al, 2003). While there is empirical evidence to suggest that relationship quality can be regarded as a higher order construct composed of several key components reflecting the overall nature of relationships between organizations and consumers (Hennig-Thurau, Gwinner, and Gremler, 2002; Chen, Shi and Dong, 2008), there is still no consensus on the components of relationship quality and its consequences. By the same token, the antecedents of relationship quality for Islamic retail banking may differ from conventional retail banking and this warrants further investigation.

While positive relationship outcomes is emphasized by financial organizations, the negative behavioral outcomes such as switching to another service provider or to another service seems to be neglected by financial institutions. The switching behavior phenomenon is worth investigating as its assessment can enable service providers to implement defensive or offensive marketing strategies to win customers and prevent attrition.

Empirical studies point out that the consequences of customers switching to another service provider as being reduced market share, impaired profitability, and increased costs (Reichheld and Sasser 1990; Rust and Zahorik 1993; Rust, Zahorik, and Keiningham 1995). Furthermore, a customer's evaluation of the relationship is central to his or her decision to continue or leave the relationship with the service provider (Hennig-Thurau, Gwinner, and Gremler, 2002).

In Malaysia, Islamic banking customers represent a new and potentially rich segment for retail banking. There is limited research on this shariah sensitive segment, particularly on the negative behavioral outcomes in a dual banking environment from a relationship marketing perspective. There may be a tendency for Islamic banking customers to switch from Islamic banking to conventional banking due to their past relationships with their service providers or when the customers perceive that there are no other alternatives available to them.

For the most part, many studies of positive relational outcomes have been done in Western countries. The two common consequences of relationship quality in previous studies include loyalty measured by recommendations and complaining, and repurchase intention measured by willingness to invest and trying out other services. From a review of the relationship marketing literature there is scant empirical studies on the consequences of negative behavioral intention. Also, research to date has focused mainly on the direct and mediator linkages between various antecedents and relationship quality.

A review of relationship quality literature reveals the use of moderating variables is rare in research models. It was found that the length of the relationship and the gender of the customers are of importance as moderating variables in retail situations, while in the business context corporate culture and uncertainty has been used as moderating variables (Athanasopoulou, 2009).

The use of alternative attractiveness as a moderating variable has been used in switching and channel relationship studies but results regarding the effect have been mixed (Sharma and Patterson, 2000; Ping, 1993; Jones et al, 2000; Yim et al, 2007). This suggests that the link between alternative attractiveness and relationship quality is another gap in the relationship marketing literature that needs to be explored. Accordingly, this research examines alternative attractiveness as a moderating variable, its effect on relationship quality, and its consequences in a dual banking setting.

Moreover, there are very few empirical studies of relationship quality conducted in East Asian countries (Chen, Shi and Dong, 2008) and a study which investigates specifically Islamic banking customers. A study by Ndubisi (2007) investigated only antecedents of relationship quality of retail bank customers in one geographical area of Malaysia, specifically Sabah and found that antecedents of relationship quality of the retail bank customers to include conflict handling, communication, trust and commitment. Consequently, a study by Amin and Isa (2008) on Islamic banking customers in Malaysia focused largely on service quality dimensions and its effect on satisfaction. They found six service quality dimensions deemed important and had an effect on satisfaction, namely, tangibles, reliability, responsiveness, assurance, empathy and compliance.

Both these studies, however, did not investigate the consequences of behavioral intentions among Malaysian retail bank customers. Due to the limited empirical research on Islamic retail banking and specifically Islamic banking customers, and in line with Gwinner's et al, (1998) suggestion for the need to understand gaps by integrating relationship marketing theories with the analysis of customer behavior in a different retail banking setting, this study investigates Islamic banking customers as end users in a dual banking environment.

Some authors have suggested that value and not quality drives customer behavior and loyalty (Bolton and Drew, 1991, Zeithaml, 1988) and this is worthy of further investigation. Other than superior service quality, delivering superior customer value is one of the most important factors for increasing financial performance and building sustainable organizations. Besides trust in the service provider, perceived value is considered to be a key factor in forging strong relationships with clients in insurance and other financial services (Durvasula et al, 2004) and therefore represents a strategy for financial service providers to achieve a sustainable competitive advantage.

Likewise, numerous authors assert that a good corporate image or reputation helps to increase the firm's sales and its market share and to establish and maintain a loyal relationship with customers (Andreassen and Lindestad, 1998; Robertson, 1993; Yoon et al, 1993). In the case of services, corporate image serves as an important factor in influencing the perception of quality, consumers' evaluation of satisfaction with the service, and customer loyalty (Andreassen and Lindestad, 1998).

It has been suggested that corporate image varies through time and thus, research on corporate image is a must for financial organizations that wish to successfully identify and manage their position in the market (Bravo et al, 2009). It is therefore pertinent to assess whether corporate image, service quality, customer perceived value and relationship quality results in negative behavioral outcomes. By comparing these relationships we enhance understanding of how consumer perceptions and evaluation motivate switching intentions in a dual banking environment.

The focus of this thesis on Islamic banking customers will, therefore, contribute to relevant literature on how these customers view their relationships with Islamic banking service providers and their consequent behavioral outcomes. It will also provide insight to financial service managers in Islamic banking for dealing with their customers and in improving relationships with them. Therefore, the application of academically developed relationship marketing models would present a platform to service providers for building and sustaining long term customer relationships and preventing customer defection.

1.5 Research Questions

In sum, the following research questions have been formulated to guide the empirical investigation of this study.

Research Question 1:

What is the significant influence of corporate image, service quality and customer perceived value on relationship quality for Islamic banking customers in a dual banking environment?

Research Question 2:

How do corporate image, service quality and customer perceived value effect relationship quality and switching intentions for Islamic banking customers in a dual banking environment?

Research Question 3:

How does relationship quality mediate the effect of switching intentions for Islamic banking customers?

Research Question 4:

What impact might an alternative attractiveness have in moderating the relationship between relationship quality and switching intentions in the research model?

1.6 Research Objectives

Understanding why customers switch and preventing such moves present mounting challenges to banks in these increasingly competitive times. It is cited that organizations should try to prevent high attrition rates since it is cheaper to retain existing customers than acquiring new ones (Reichheld and Sasser, 1990). Therefore the objectives of this study are as follows:

1. To examine the significant influence of corporate image, service quality and customer perceived value on relationship quality for Islamic banking customers in a dual banking environment.

2. To investigate effects of corporate image, service quality and customer perceived value on relationship quality and switching intentions for Islamic banking customers in a dual banking environment.
3. To determine the role of relationship quality as the mediator between corporate image, service quality, customer perceived value and switching intentions for Islamic banking customers
4. To investigate alternative attractiveness as a moderating variable between relationship quality and Islamic banking customers' switching intentions

1.7 Significance of the Study

This research seeks to expand the body of knowledge in relationship marketing with emphasis on relationship quality. The benefits that will be yielded from this study will not only provide guidelines to Islamic service providers, but will also enhance current understanding of customer relationships in a dual banking environment.

A significant contribution is made in bridging information gaps through the investigation of the switching phenomenon among Islamic banking customers in a dual banking setting. This is vital for Islamic banking service providers because as customers have many more choices and will move if they are dissatisfied, Islamic banking service providers need to do more to provide better overall experience.

Another contribution is the adoption of structural equation modeling (SEM) to examine the switching intentions of Islamic banking customers. To date an integrated model using structural equation modeling has not been used in an Islamic banking context to determine the effect of corporate image, service quality and customer perceived value on relationship quality and the consequences of these relationships. Thus, the use of SEM is a contribution for this research.

Finally, this study highlights the essential aims of relationship marketing and its influence on switching intentions. The identification of specific relational variables which are found to be responsible for the switching phenomenon provides a helpful tool for Islamic banking service providers to prevent attrition amongst their customers. Thus, the outcome of this study could help managers to take specific steps to build relationship quality and determine which attributes contribute to negative behavioral intentions in the context of Islamic banking in Malaysia. Further, customer franchises can be strengthened by Islamic banks that start these processes so that they may be well positioned for long term success in these potentially rich markets.

1.8 Organization of the Thesis

The thesis is organized into five chapters. Chapter 1 provides an introduction to the study. This chapter discusses the importance of relationships between financial service providers and their customers, provides an overview of Islamic banking as well as highlights the issues addressed by this study.

Chapter 2 traces past theoretical underpinnings employed in this study and the studies pertaining to the constructs are rigorously discussed. Finally, a model that serves as the framework of this study is presented at the end of this chapter.

In Chapter 3 presents a complete description of the study approach is presented. The theoretical framework is presented followed by the research methodology for the study. This includes research design, instrument development, the method used for data collection and plan for data analysis is discussed. Chapter 4 details the results from the analysis of data which are interpreted, both statistically and inferentially. The findings are explained by responding to each hypothesis and research questions which were developed in the preceding chapters.

Chapter 5 discusses the findings of the study and their implications from managerial and theoretical perspectives. It also reports on the contributions and limitations of this study. Finally, Chapter 5 concludes with some directions for future research.

1.9 Chapter Summary

This chapter discusses the background of the study and relationship marketing between service providers and their customers in Malaysia. The negative behavioral intention, specifically the switching intention, is also discussed. Chapter 1 concludes with a section on the organization and an outline of the contents of the five chapters of this thesis.