The Effect of Service Quality on Customer Loyalty

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Abstract
Competition in the banking industry is higher than ever before which has created a need for the development of new strategies to retain the existing customers rather than attracting new customers. Making loyal customers to the banks has become essential for the long term survival of any bank where the service quality of the banks has also played an important role in customer loyalty. This study attempted to find the relationship between service quality dimensions and customer loyalty in the Commercial Banks of Sri Lanka. The data collected from 300 customers of four leading commercial banks through questionnaires. Further, five hypotheses were formulated for the study. The findings revealed that three dimensions of service quality namely tangibles, reliability and empathy have significant positive effect on customer loyalty. Further service quality dimensions alone explain 43.9% of the variance in customer loyalty.
Keywords: Service quality, Customer loyalty, SERVQUAL, Banking industry

1. Introduction

The competition in the marketing of services is more competitive than the product marketing (Zeithaml, Bitner, Gremler and Pandit, 2011) because of its' special characteristics such as intangibility, heterogeneity, inseparability and perishability. The arrival of new firms in the market with almost similar products or services led to high competition and made the customers avail with a number of options or choices which in turn equipped them with high bargaining power. Service organizations are seeking ways to forge and to maintain an on-going relationship with their customers in order to protect their long term interest (Kandampully, 1998). Retention of existing customer is cheaper than attracting new customers. This reveals the need for building customer loyalty through long-term customer relationships.

Service quality is one of the important antecedents of customer loyalty which has an impact on customer loyalty (Bloemer, Ruyter, and Peeters, 1998). It is also considered as a prerequisite for satisfying and retaining the valued customers and also identified as an antecedent of sustainable competitive advantage (Guo, Duff and Hair, 2008). Therefore, this is an attractive area for researchers over the last decade, especially in the banking sector (Bloemer*et al*., 1998; Ruyter and Peeters, 1998; Caruana, 2002; Dhandabani, 2010; Sureshchandar, Rajendran, and Anantharaman, 2002; Mosahab, Mahamad, and Ramyah, 2010). Sri Lankan marketers also started to realise the significance of customer loyalty to their business. To achieve customer loyalty, management should meet the diverse customer demands. According to Parasuraman, Zeithaml, and Berry (1985) service quality is positively related to loyalty because improved service quality could enhance loyalty.

Even, there are a number of researches that investigate the relationship between service quality and customer loyalty in different industries across the globe, there is not that much of importance given to the researches on customer loyalty in Sri Lankan context. Since there were few studies found in testing the relationship between the constructs service quality and customer loyalty, still there is a need to fill the empirical gap. The current study focuses to investigate "whether there is a significant relationship between service quality dimensions and customer loyalty in Commercial Banks of Sri Lanka?"

2. Literature Review

2.1 Service quality

During past few decades service quality has drawn lots of attention from practitioners and researchers due to its importance. Gronroos (1984) defined service quality as the outcome of the evaluation process, where the customer compares his expectation with the service he perceives while he actually received. Here, the expectation of a customer regarding the service is compared with his/ her actual perception of the service. Similarly, Parasuraman Berry and Zeithaml(1988) delineated the service quality as the consumer's overall evaluation of a specific service firm that results from comparing that firm's performance with the customers' general expectations of how firms in that industry should perform.

2.2 Customer loyalty

The conceptualisation of customer loyalty has evolved over the years.Customer loyalty is defined as customer's repeated patronage over a certain period of time (Yi and Jeon, 2003; Ladhari, Ladhari,and Morales, 2011). Gremler and Brown (1996) defined service loyalty as the degree to which a customer exhibits repeat purchasing behaviour from a service provider, possesses a positive attitudinal disposition toward the provider, and considers using only this provider when a need for this service arises. Further, Ou*et al.* (2011) defined loyalty as a held commitment to

re-buy or re-patronize a preferred product consistently in the future. This was further explained by Oliver (1997) as a deeply held commitment to rebuy or repatronize a preferred product or service consistently in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational influences and marketing efforts that have the potential to cause switching behaviour.

3. Conceptual model
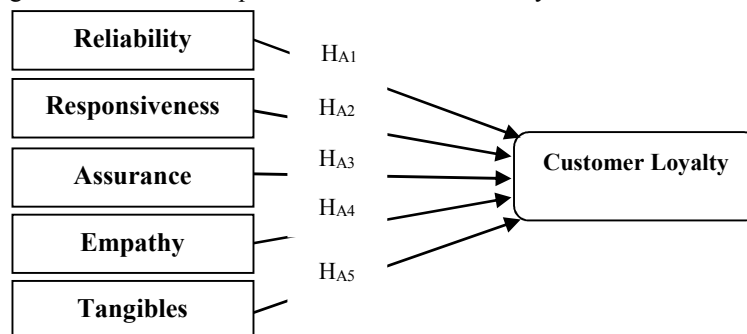The following figure shows the conceptual framework of the study.

Figure 1: Conceptual framework

4. Method
4.1 Development of instruments
The instrument used to collect the data was adopted from the validated models, thus it has its content validity. The SERVQUAL model proposed by Parasuraman *et al.* (1988) was used to measure service quality. The instrument consists 21 items which fall under five dimensions, namely reliability, responsiveness, assurance, empathy and tangibles. The effects of service quality on customer loyalty was tested directly with its' dimensions. All the items in the model were positive. Then, the items were finalized on a five-point Likert scale (1= strongly disagree, 5= strongly disagree), respondents were asked to rate their agreement and it has found an acceptable Cronbach Alpha value (0.789)from the pilot study responses.

Customer loyalty was adopted from the Behavioural intention battery of Zeithaml *et al.* (1996) which comprised five items: say positive things, recommendation, encourage friends and relatives to do business with, first choice and do more business. The measure was assessed on a five-point scale and the Cronbach's Alpha value of this scale was 0.92. Numerous studies have adopted this instrument as it has an acceptable validity and reliability. To test the relationship between the constructs the following hypotheses were formulated.

H $_{A1}$: There is a significant positive relationship between reliability and customer loyalty.
H$_{A2}$: There is a significant positive relationship between responsiveness and customer loyalty.
H $_{A3}$: There is a significant positive relationship between assurance and customer loyalty.
H $_{A4}$: There is a significant positive relationship between empathy and customer loyalty.
H $_{A5}$: There is a significant positive relationship between tangibility and customer loyalty.

4.2 Data collection
The study population comprised all the individual customers of Commercial Banks in Sri Lanka. However, respondents' age below 18 years such as school children were excluded from the population due to their different banking needs. Further, customers of four leading banks, which have a comparatively long history; Bank of Ceylon, Peoples Bank, Hatton National Bank PLC and Commercial Bank PLC, were selected for the study. Based on the proportion of customers of each bank, the sample was selected and data collected from 300 respondents. The respondents were approached in the respective bank entrance using convenience sampling method. The valid sample was as restricted to 254.

5. Data Analysis
The data were analysed using the Statistical Package for Social Sciences (SPSS) Version 21.0 in order to describe the demographic information and characteristics of research information. SmartPLS version 3.0 was used in the test of hypotheses.

5.1 Reliability and validity
The strength of the measurement model is ensured by the examination of factor loading and internal consistency reliability. Outer loadings of all indicators of all constructs were ranged between 0.613and 0.852 and were statistically significant. Thus, the indicator reliability was established. Further, the composite reliability of the constructs service quality dimensions; reliability, responsiveness, assurance, empathy and tangibles and customer

loyalty were correspondingly 0.875, 0.855, 0.855, 0.899, 0.855, and 0.873. As all the composite reliability values were above the widely recognised rule of thumb of 0.7, the internal consistency reliability was proved.

The measurement models' validity assessment focuses on convergent validity and discriminant validity. The convergent validity is attested based on the value of Average Variance Extracted (AVE). The values of each service quality dimension (reliability, responsiveness, assurance, empathy and tangibles) and customer loyalty were respectively 0.584, 0.597, 0.597, 0.641, 0.6 and 0.590. Since all the values were above the threshold value of 0.5, the convergent validity was confirmed. Further, Hair, Anderson, Tatham and Black (1998) stated that discriminant validity assesses the extent to which a measure does not correlate with other constructs from which it is supposed to differ. As all the diagonal values were significantly larger than the correlation of specific construct with any other constructs, adequate discriminant validity was ensured (Hair, Ringle and Sarstedt,2011; Fornell and Larcker, 1981). Moreover, Hair *et al.* (2011) emphasised that loadings of indicators of individual constructs should be higher than its cross loading. As expected, all the indicators had high loading with its' predestined construct. Thus, the discriminant validity is confirmed and sufficient to support the model of this study.

5.2 Demographic and research information

Among the respondents majority were female (54.7%) and the remaining were male. 63.4% of the respondents were the customers of government banks while remaining were private bank customers.

Table 1: Mean values, standard deviations and the levels of service quality dimensions and customer loyalty

Variables	Mean	Standard Deviation	Levels		
			Low	Moderate	High
Tangibles	4.086	0.585	2	44	208
Reliability	3.966	0.609	6	42	206
Responsiveness	3.869	0.631	6	73	175
Assurance	3.886	0.654	7	72	175
Empathy	3.518	0.736	23	97	134
Loyalty	3.740	0.674	13	67	174

(Source: Survey data)

Table 1 shows the mean values and the standard deviations of service quality dimensions and customer loyalty. The mean values of all the service quality dimensions fall in between 3.51 to 4 which shows a higher level of service quality respective to all dimensions and the level of service quality of all dimensions of the banks also high. Further, mean value of customer loyalty is 3.74 which also indicates a higher level of customer loyalty.
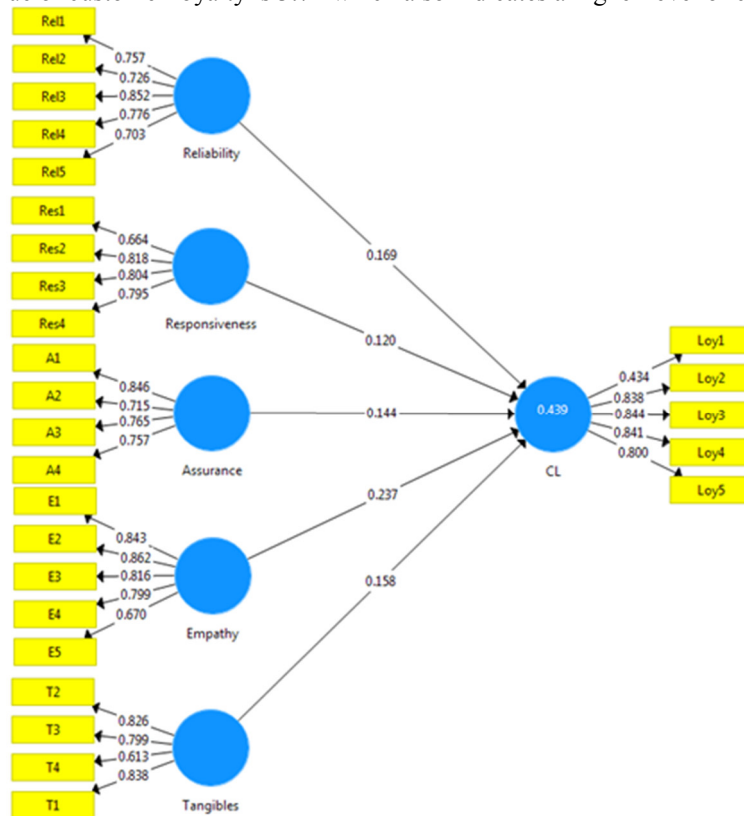

Figure 2: Structural model
(Source: Survey data)

The structural model was used to determine the model's explanatory power and to test the hypotheses. The model's explanatory power was assessed by the coefficient of determination, R^2. The coefficient of determination (R^2) for the "customer loyalty" construct was 0.439 (see figure 2) which means that five dimensions of service quality explains 43.9% of the variance in customer loyalty.

Another important assessment of structural model is the models' capability to predict. The Q^2 value was obtained using blindfolding procedure with omission distance seven. As all the values were larger than zero, the model adequately predicts each indicator of the endogenous latent constructs.

5.3 Hypotheses testing
As shown in Table 1, the hypotheses were tested using the path coefficient (*β*) indicating the strength of the cause-effect relationship between the constructs using the *p* value (Hair *et al.*, 2011; Wong, 2013). The bootstrapping procedure was used to assess the significance of path coefficient values (*β*) and statistical significance was tested at 5% ($p<0.05$).

Table 1: Research hypotheses testing

Hypotheses	Path coefficient (β)	*P* values	Supported/Not Supported
Hypothesis 1: Tangibles → Customer loyalty	0.158	0.013	Supported
Hypothesis 2: Reliability → Customer loyalty	0.169	0.013	Supported
Hypothesis 3: Responsiveness → Customer loyalty	0.120	0.178	Not supported
Hypothesis 4: Assurance → Customer loyalty	0.144	0.100	Not supported
Hypothesis 5: Empathy → Customer loyalty	0.237	0.001	Supported

(Source: Survey data)

The inner model suggests that the dimension of empathy has an effect on customer loyalty (0.237), followed by reliability (0.169) and tangibles (0.158). Thus, it is concluded that the hypothesized path relationship between constructs; tangibles and customer loyalty; reliability and customer loyalty; and empathy and customer loyalty were positive and statistically significant where responsiveness and customer loyalty; and assurance and customer loyalty were positive but statistically insignificant. The current study findings coincide with the findings of previous studies in checking the relationship between the service quality dimensions and customer loyalty in different context. Kheng, Mahamad, Ramayah, and Mosahab (2012) found a positive relationship between reliability, assurance and customer loyalty in Malaysian banks. In the Pakistani banking environment Malik, Naeem and Arif (2011) found a significant impact of service quality dimensions; tangibles and empathy on customer loyalty where tangibles posted more impact than the other. Moreover, Saravanakumar and Jothi Jayakrishnan (2014) found that both reliability and empathy significantly influence on customer loyalty in the Co-Operative banks in India. Similar to the current findings, significant relationship between responsiveness and customer loyalty was rejected by Kheng *et al.* (2012) and Malik *et al.* (2011).

6. Conclusion

The finding revealed that tangibles, reliability and empathy had a significant positive effect on customer loyalty while the effects of responsiveness and assurance on customer loyalty were positive but not significant. Therefore, banks should develop proper strategies to tangibilize the intangible services, to provide reliable services to customers and to deliver customised services to customers with more care. Although the mean value of empathy shows a higher level of service quality, the value is comparably lower than the value of other dimensions and further, its' influence on customer loyalty is comparably higher than the other dimensions. Therefore, banks should give more attention specifically to the dimension of empathy through giving individualised attention to the customers by employees and understanding the specific needs of the customers and their convenience.

7. Implications

The current study revealed the applicability of the SERVQUAL model of 22 items of Parasuraman *et al.* (1988) in the Sri Lankan context. This study confirmed the fivefold service quality dimensions namely, tangibles, reliability, responsiveness, assurance and empathy in the commercial banking sector in the Sri Lankan context, proving service quality as a multidimensional construct as mentioned in the literature. The current study narrowed the empirical gap by exploring the role of service quality on customer loyalty. Since the offerings of the banks are more or less similar in the competitive banking industry, one bank can differentiate itself from another only through the quality of the service they deliver. Developing higher levels of service quality in the banks leads to enhance customer loyalty.

8. Future research direction

Even though the current study narrowed the empirical gap, it still provides a pathway for future research. First, the objective of the current study was to explore the impact of service quality on customer loyalty in Commercial Banks of Sri Lanka therefore it did not include banks other than Commercial Banks in the banking industry. Thus the scope of generalizing the results to other contexts and to whole Sri Lanka may be limited. Therefore, covering the whole banking industry in entire Sri Lanka may provide new findings. Further, replications in other service contexts are highly desirable. Comparisons of models among individual banks as well as comparison of models of government and private banks will give more understanding on the difference between them. Further, developing a richer model that incorporates other constructs such as customer satisfaction, value, trust and corporate image also give more insights.

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