

Islamic Bank Service Quality and It's Impact on Indonesian Customers' Satisfaction and Loyalty

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Abstract. *Customers are still in doubt of its professionalism. Superiority in products and service quality remains in sufficient for customer satisfaction and loyalty. The data sets in this research were analyzed by using path analysis for testing the direct impact and sobel test for indirect impact. The result shows that Islamic bank service quality in Indonesia impacts customer satisfaction and loyalty. However, customer satisfaction does not impact customer loyalty, both directly and indirectly. It means that customers are still dissatisfied with the services provided by Islamic banks. This research recommends strategies for improving service quality and consumer confidence on the distinction of Islamic banking system.*

Keywords: *Islamic banks, Islamic service quality, customer satisfaction, customer loyalty*

Abstrak. *Nasabah masih meragukan profesionalisme perbankan syariah. Keunggulan produk dan kualitas layanan merupakan hal penting yang mendasari tumbuhnya kepuasan dan dan loyalitas nasabah. Data dalam penelitian ini dianalisis menggunakan analisis jalur untuk menguji hubungan langsung dan uji Sobel untuk menguji hubungan tidak langsung. Hasilnya menunjukkan bahwa kualitas layanan Islami bank syariah mempengaruhi kepuasan dan loyalitas nasabah, namun kepuasan nasabah tidak mempengaruhi loyalitas nasabah baik secara langsung maupun tidak langsung. Artinya nasabah masih belum cukup puas dengan layanan bank syariah. Karenanya, penelitian ini bermaksud merekomendasikan strategi yang dapat meningkatkan kualitas layanan dan kepercayaan nasabah akan keunggulan sistem perbankan syariah.*

Kata kunci: *perbankan syariah, kualitas layanan Islami, kepuasan nasabah, loyalitas nasabah*

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Introduction

During the last three decades, Islamic banking has emerged and got momentum and become a global phenomenon with warm acceptance from Moslem and non-Moslem customers (Faisal et.al, 2016). Many conventional banks, even from non-Moslem countries, are providing Islamic banking facilities, as example Citibank, HSBC, OCBC, Standard Chartered, etc (Akhtar and Zaheer, 2014). However according to the Financial Stability Report 2016 - IFSB, despite as the country with the largest Moslem population in the world, Indonesia is still in the tenth rank based on the shares of global Islamic banking assets after Iran, Saudi Arabia, Malaysia, UAE, Kuwait, Qatar, Turkey, Bahrain and Bangladesh (Zamir, 2016). According to the Global Advisors' Islamic Finance Outlook Report for 2016, no Indonesian Islamic banks were ranked in the top five largest banks based on assets in Southeast Asia. The performance of the Islamic banking industry in Indonesia has yet to satisfy the public's expectations. For three consecutive years, the market share of the Islamic banks in the country stood still at less than 5 percent.

Islamic banking provides products and services that conforms to *sharia* (Islamic law) which strictly forbid not only *riba* (usury) or the excess interest charge such as additional charge on loan, but also forbid the involvement of other unethical activities like speculation and gambling (Lajuni et.al, 2017). Islamic banks are not burdened with paying interest for customer deposits. Islamic banks only pay a share of profits in accordance with the profit-sharing ratios of Islamic banking. With the profit-sharing system, Islamic banks certainly survived the negative spread. Rather than collapsed as with the conventional banks in general, the past economic and financial crisis, instead, had positive impacts on the development of Islamic banks. Islamic banks in Indonesia comprise of 12 fully fledged Islamic banks and 22 conventional banks have Islamic banking windows. Indonesian authorities want Indonesia's Islamic banks to hold at least 15% of the market by 2023. But inreality, lots of Indonesian customers are still in doubt of Islamic bank service quality and professionalism because superiority in products and service quality remains necessary for customers (Hidayat et.al, 2015). For customers, quality of services is viewed as the standard type of the service offered to them, how it is performed and the extent of its fulfillment to their needs, desires and hopes which requires continual service improvement (Hammoud and Bittar, 2016). Customer satisfaction and loyalty will grow if the products and services meets with customer expectations (Amin, 2011).

Although there are already lots of previous researches analyzing about Islamic banks' service quality, most of them still used a conventional measurement that derived from Western perspective especially the five multi-dimensions of SERVQUAL (assurance, reliability, tangibles, empathy, and responsiveness) proposed

by Parasuraman et.al. in 1988. Unlike other financial institutions, Islamic bank must fully comply with *sharia*. Thus in its all practices, including the service quality offered by Islamic bank must also appropriates to Islamic principles and values. Rather than applying a conventional measurement of service quality, this research will shed light on Islamic perspective measurement of Islamic banks' service quality by using an instrument called CARTER proposed by Othman and Owen in 2001 that consists of six dimensions by adding "compliance" as the new dimension which will define Islamic bank's ability to operate in compliance with the principles of *sharia* or Islamic law.

As its development, in the dimension of compliance, this research will measure not only wheather the customers sure that in its practices, Islamic bank is not engaged with interest based transactions, but also will measure wheather the customers sure that Islamic banks always conduct financial transactions that are connected with economic activities in real sector rather than financial sector like many other conventional bank practices, or not participate in transactions that could exploit any party, and not participate in activities that are regarded as harmful to the society which are assembled within the Islamic principles. Therefore, this research will measure the level of Islamic service quality implementation in Islamic banking by using CARTER instrument, especially in Bank Syariah Mandiri (BSM) in South Jakarta as sample. BSM is the largest Islamic bank in Indonesia which from 2011 to 2014 had achived the best Service Quality Award. However, according to the Service Quality Index in 2015 and 2016, BSM was in the second place after BNI Syariah, followed by Bank Muamalat, BCA Syariah and BRI Syariah.

In addition, most of previous researches only discussing service quality impacts on customer satisfaction or customer loyalty separately. While in this research, besides analizing Islamic banks' service quality impact on customer satisfaction and customer loyalty directly and separately, this research will also analyze its impact on customer loyalty indirectly through customer satisfaction as an intervening variable. By measuring its level of service quality and analyze its impact on customer satisfaction and customer loyalty both directly and indirectly, this research will offer recommendations and strategies for improving service quality and consumers' confidence on the distinction of Islamic banking in Indonesia that is safe and fair for customers, Moslem and non-Moslem.

Literature Review

As the outcome of customer's current evaluation and consumption experience, service quality is expected to have a direct and positive effect on overall customer satisfaction. The service quality concept of banking, does not differ from the concept

of service quality in general (Zeithami et.al, 1996; Hidayat et.al, 2015; Hammoud and Bittar, 2016). However, because Islamic banking is accordingly to *sharia*, which is different from conventional banking in several ways, such as the prohibition of transactions based on interest rate and the requirement that bank operations be carried out accordingly to certain procedures through the use of certain financial instruments, it is important to pattern the compliance for Islamic banking quality services (Othman and Owen, 2001a; Akhtar and Zaheer, 2014; Faisal et.al, 2016).

To understand customer needs of Islamic banking quality service, Othman and Owen (2001a) developed an instrument called CARTER that consists of six dimensions which developed from the first five dimensions of service quality called SERVQUAL proposed by Parasuraman et.al. (1988). A new dimension of “compliance” was added to define Islamic bank’s ability to operate in compliance with the principles of Islamic law. The six dimensions of CARTER are (Othman and Owen, 2001a; Akhtar and Zaheer, 2014; Faisal et.al, 2016): *first*, Compliance, refers to compatibility of bank services with Islamic laws and principles; *second*, Assurance, is the services of awareness and politeness of the workforces that employed by the Islamic bank. It also comprises of all types of communication between the Islamic bank workforces with customers; *third*, Reliability, is the capacity to deliver the promised services in dependable and accurate manner; *fourth*, Tangibles, refers to the appearance of physical components; *fifth*, Empathy, is the ability of workforces to considerate and customize attention for customers; and *sixth*, Responsiveness, is the ability and willingness of worforces to help customers and provide prompt services.

A prompt quality services provided by Islamic bank will achieve customer satisfaction. The satisfied customers share their positive experiences with others and become the source of word-of-mouth advertising. On the other hand, unsatisfied customers share negative word-of-mouth and more likely switch to other products or services. A bank needs to be aware on the satisfaction of their customers which is expected with the increase of customer using capacity (Hamzah et.al, 2015). Customer satisfaction represents a modern approach for quality in organizations that serves the development of a customer-focused management and culture (Mihelis et.al, 2001 and Hamzah, et.al, 2015).

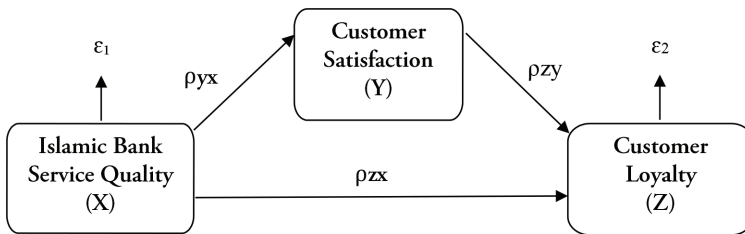
Because loyalty is facilitated by customer satisfaction (Kishada and Wahab, 2013), customer satisfaction is a determinant for Islamic banking to increase their customer value which will inculcate customer loyalty and assist the organization to be more competitive. In the absence of satisfaction, customers are unlikely to spend more on company products or services and recommend the product or services to others. Many scholars has defined loyalty as a deeply-held predisposition to re-

patronize a preferred brand or service consistently in the future, thereby causing repetitive same brand purchasing, despite situational influences and marketing efforts having the potential to cause switching behavior (Oliver, 1999). Loyalty also refers to a consumers' commitment to repurchase a preferred product and service consistently in the future (Amin, 2011). Thus, customer loyalty is an intended behavior that is related to a product, service, the brand or the organization.

The characteristic of customer loyalty had been categorized into four sequential phases (Oliver, 1999; Rai and Srivasta, 2012). *First*, Cognitive loyalty. The customer believes a product, service, the brand or the organization is superior rather than others and chooses it over others and the information about it will affect consumer buying decision. *Second*, Affective loyalty. Reiterated confirmations of customer expectations lead to affective form of loyalty where a particularly favorable attitude gets developed towards the product, service, the organization or the brand. *Third*, Conative loyalty. High involvement and motives fueled by strong buying intentions will give way to the development of an intense form of loyalty. *Fourth*, Action loyalty. Strong motivations that ultimately lead to actions directed by the need to remove every possible problem that might hinder the loyalty driven decision of purchasing a specific product, service, the brand or the organization.

Based on the literature reviews, the hypotheses in this research are (see Figure 1): (1) Islamic service quality directly impacts customer satisfaction, (2) Islamic service quality directly impacts customer loyalty, (3) Customer satisfaction directly impacts customer loyalty, and (4) Islamic service quality indirectly impacts on customer loyalty through customer satisfaction.

Figure 1. Path Analysis Model



Method

This research is a field research that was done by survey and used primary data that was collected by personally administered questionnaires techniques. As instrument, the questionnaires are directly delivered and collected by the researcher

(Indriantoro and Supomo, 2002). The questionnaires used Likert scale model that was conducted by measuring five categories of responses that requires the respondent to determine the degree of approval or disapproval of each variables (Maholtra, 2009), with a weight of 5 (strongly agree), 4 (agree), 3 (neutral), 2 (disagree) and 1 (strongly disagree) (Riduwan and Kuncoro, 2008).

This research used probability sampling technique with convenience sampling. The sample is the customers of Bank Syariah Mandiri that located in South Jakarta. To calculate the sample size of the population of Indonesian customers' Islamic banking, this research used the estimations of mean value with 95% of confidence level which is obtained 96.04 samples (Wibisono in Riduwan and Kuncoro, 2008). Thus, this research will use 100 respondents as samples. After the development of instrument, the data testing was conducted by validity and reliability test, continued with normality test (Ghozali, 2013).

Path analysis was used to analyze the patterns of relationships between variables with the aim to find out directly or indirectly influence the set of independent variables (exogenous) against the dependent variable (endogenous) (Riduwan and Kuncoro, 2008). If the p value is equal or less than 0.05, the statistically analysis is significant at 95% confidence level. The equation model is breakdown into two substructures as follows:

$$Y = \rho_{yx}X + \varepsilon_1$$

$$Z = \rho_{zx}X + \rho_{zy}Y + \varepsilon_2$$

Every sub structure run by several test of coefficient of determination (adjusted R-square) test, simultaneously (F) test, partial (t) test.

This research will also use Sobel test to determine whether customer satisfaction is an intervening variabel or whether there is indirect impacts between Islamic bank service qualities with customer loyalty through customer satisfaction, with a formula as follows:

$$Sp2p3 = \sqrt{p3^2Sp2^2 + p2^2Sp3^2 + Sp2^2Sp3^2}$$

Description:

p2 : beta of Islamic service quality in unstandardized coefficient column.

p3 : beta of customer satisfaction in unstandardized coefficient column.

Sp2: standard error of Islamic service quality in unstandardized coefficient column.

Sp3: standard error of customer satisfaction in unstandardized coefficient column.

A variable called an intervening variable if the variable indirectly impact the relationship between independent and dependent variable (Baron and Kenny, 1986 in Ghozali, 2013). The sobel test was used to test the strength of the indirect impact

of independent variables (X) to the dependent variable (Z) through an intervening variable (Y) (Sobel, 1982 in Ghozali, 2013).

Result and Discussion

This research used 50% female and 50% male respondents. Based on the age, the majority of respondents (80%) are in the productive age between 18-56 years. Based on the amount of income per month, the majority of respondents (66%) came from the middle economic class with income between IDR 3 to 10 million per month. To measure the customer loyalty, all respondents must have been become customers for more than two years. The validity dan realibility tests showed that all items were valid and all variables were reliable. From normality test it can be concluded that the data is normally distributed.

Table 1. Coefficient Determination Test Result of Sub Structure I

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.567 ^a	.321	.314	5.474

a. Predictors: (Constant), ISQ

The calculation results of coefficient of determination (adjusted R-square) test, simultaneous (F) test and partial (t) test of Sub Structure I as follows: the adjusted R-square value is 0.314, it means that 31.4% of the variation of the customer satisfaction (Y) can be explained by the variation of one independent variable of the Islamic service quality (X), while the rest (68.6%) was explained by other causes beyond the model (See Table 1). From the simultaneous hypothesis testing, the F value is 46.351 with a probability of 0.000, while from the partial hypothesis testing; the calculation of t test value was obtained 6.808 with the probability of significance 0.000 (See Table 2).

From the partial hypothesis testing, the calculation of t test value was obtained 6.808 with the probability of significance 0.000. With a significance level of 0.05 and degrees of freedom with $df = n-2, 100-2 = 98$, the number of t table is 1.664. The result of t test value (6.808) is greater than t table (1.664) with the significantcy level of 0.000 that is less than 0.05 (See Table 3). Thus, Islamic service quality significantly impacts customer satisfaction. Most of empirical studies have proposed a causal relationship between service quality and customer satisfaction. Many researchers founded the fact that service quality is a sufficient measurement of customer satisfaction (Hamzah et.al, 2015). Customers

will satisfy if the services provided by the company meets with their expectations (Amin, 2011).

Table 2. F Test Result of Sub Structure I

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1388.744	1	1388.744	46.351	.000 ^b
Residual	2936.216	98	29.961		
Total	4324.960	99			

a. Dependent Variable: CS

b. Predictors: (Constant), ISQ

Service quality is the key factor to increase customer satisfaction. The level of satisfaction is created by particular transaction between the bank and the customer as psychological condition that generates when emotional factor encourages customer expectation that is adopted from the past consumption experiences (Oliver, 1981 in Hidayat et.al, 2015). Thus, in banking industry, service quality is an important element to gain success, to grow up and to be able to compete with competitors. However, financial services provided by banks generally undifferentiate. To become different, the bank needs to continually improve their service quality which is critical for the expansion of its market share (Dahari et.al, 2015). To improve their service quality, the bank needs to measure and evaluate their service quality first.

Table 3. t Test Result of Sub Structure I

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	22.599	4.569		4.947	.000
ISQ	.810	.119	.567	6.808	.000

a. Dependent Variable: CS

Lots of previous studies used the five multi-dimensional construct of service quality called SERVQUAL proposed by Parasuraman et.al. in 1988 (Hamzah et.al, 2015). According to Zeithaml et.al. (1996) service quality is measured as the outcome of customers' current evaluation and consumption experience which is expected to

have a direct and positive effect on customer satisfaction in overall. Parasuraman et.al. (1985) in Hammoud and Bittar (2016) assured that lots of researchers found many problems when they tried to interpret the measurement of service quality because they only used one dimension from their own perspective. At first in 1985, they tried to find a more suitable criteria of its measurement from customer perspectives by using a survey focus groups and found ten new criteria in evaluating service quality which were: reliability, responsiveness, tangibility, competence, access, courtesy, communication, credibility, understanding the customers, and security (Hammoud and Bittar, 2016). Then in their earlier work, Parasuraman et.al. (1988) sought to develop a general instrument of service quality measurement which they called SERVQUAL that only consists of five dimensional construct, while the other five dimensions were already imbedded in the first five dimensions. They are: tangibility (appearance of physical components), reliability (dependability of service provider and accuracy of performance), responsiveness (promptness and helpfulness), assurance (knowledge and courtesy of employees and their ability to inspire trust and confidence), and empathy (caring, individualized attention that the firm gives its customers) (Hamzah et.al, 2015; Hidayat et.al, 2015; Hammoud and Bittar, 2016). While Mihelis et.al. (2001) divided customer satisfaction in to four factors which are personnel, image, services offered and accessibility. Personnel includes of skills, knowledge, responsiveness and friendliness communication of the banks. Image, consists of the technology excellence and ability to satisfy future needs. Services offered, contains of the appearance of the bank, waiting time, service processes and an adequate information given. Accessibility, comprises of the network expansion, branches location, service system and the location of the bank

Unlike other financial institutions, Islamic bank must fully complies with *sharia*. Thus in its all practices, including the service quality offered by Islamic bank must also appropriates to Islamic principles and values (Othman and Owen, 2001a; Hassan et.al, 2012; Akhtar and Zaheer, 2014; Hidayat et.al, 2015; Faisal et.al, 2016). To understand customer needs and to improve Islamic bank services and performance, Othman and Owen (2001a) developed a new instrument called CARTER for Islamic service quality measurement that consists of six dimensions. This was the first time a new dimension of “compliance with Islamic principles” was added along with other five dimensions of SERVQUAL which are: assurance, reliability, tangible, empathy and responsiveness (Akhtar and Zaheer, 2014; Faisal et.al, 2016).

From the results of descriptive statistical analysis, the service quality level of Islamic bank in this reseach is high with 3.813 mean value. The criteria of the mean levels are: 1 to 2 is very low; 2.1 to 3 is low; 3.1 to 3.5 is average; 3.6 to 4.5 is high;

and 4.6 to 5 is very high. This high level of service quality was constructed from the six dimensions of CARTER. The highest construct is developed from Assurance (3.940). According to customers, the awareness and the politeness of Islamic bank workforces is high. They also have established a good communication with the customers. Followed by Tangibility (3.830) that refers to the good appearance of Islamic bank physical components such as waiting room, teller desk, atm and the office appearance in overall. Then followed by Responsiveness (3.815), which refers to the ability and willingness of Islamic bank workforces to help their customers. While both Compliance and Reliability are equally high (3.800). According to customers, the bank is able to operate in compliance with the Islamic principles and laws. They sure that in its practices, Islamic bank is not engaged with interest based transactions, conduct financial transactions which are connected with many real economic activities; not participate in transactions that could exploit any party; and not participate in activities that are regarded as harmful to the society. Equal to the Compliance, the customers also feels that the Reliability or the Islamic bank commitment to provide the promised services is steady and accurate. The last is Empathy (3.695). The customers feels that the Islamic bank workforces are able to considerate and customize high attention to their needs. This level of Islamic bank service quality equates and significantly impacts on customer satisfaction based on the results of partial hypothesis testing which means that the services provided by the Islamic bank meets with customer expectation and equates as a sufficient measurement of customer satisfaction (Amin, 2011; Ali and Raza, 2015).

For Sub Structure II, the results as follows: the amount of adjusted R-square is 0.154, it means that 15.4% of the variation of the customer loyalty (Z) can be explained by the variation of two independent variables of Islamic service quality (X) and customer satisfaction (Y). While the rest (84.6%) explained by other causes beyond the model (See Table 4). The adjusted R-square value is low, however, there are two major reasons why it can be just fine to have low R-square or adjusted R-square values. In some fields, it is entirely expected that R-square or adjusted R-square values will be low. For example, any field that attempts to predict human behavior (in this case is customer satisfaction and loyalty), typically has R-square values lower than 50%. Humans are simply harder to predict than, say, physical processes. Furthermore, if R-square value is low but the research has statistically significant predictors, it can still draw important conclusions about how changes in the predictor values are associated with changes in the response value. Regardless of the R-square, the significant coefficients still represent the mean change in the response for one unit of change in the predictor while holding other predictors in the model constant (Frost, 2013).

Table 4. Coefficient Determination Test Result of Sub Structure II

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.414 ^a	.172	.154	2.783

a. Predictors: (Constant), CS, ISQ

From the simultaneous hypothesis testing, the F value is 10.042 with a probability of 0.000 which is much smaller than 0.05 (See Table 5). Thus, the Islamic service quality and customer satisfaction impact customer loyalty simultaneously. From the partial hypothesis testing of the impact of Islamic service quality on customer loyalty, the calculation of t test value was obtained 3.138 with the probability of significance 0.002. With a significance level of 0.05 and degrees of freedom with $df = n-2$, $100-2 = 98$, the number of t table is 1.664. The result of t test value (3.138) is greater than t table (1.664) with the significantcy level of 0.002 that is less than 0.05, thus, the Islamic service quality significantly impacts the customer loyalty (See Table 6).

Table 5. F Test Result of Sub Structure II

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	155.585	2	77.793	10.042	.000 ^b
Residual	751.455	97	7.747		
Total	907.040	99			

a. Dependent Variable: CL

b. Predictors: (Constant), CS, ISQ

Many researchers found out that service quality increases market share and repeated sales that ultimately leads to the customer loyalty (Rust et.al, 1993 in Badara et.al, 2013). A high level of service quality also enhances customer tendency to use more services, to become less price-sensitive and willing to tell others about the favorable and useful services provided by the company (Kishada and Wahab, 2013).

From the partial hypothesis testing of the impact of customer satisfaction on customer loyalty, the calculation of t test value was obtained 0.859 with the probability of significance 0.393. With a significance level of 0.05 and degrees of freedom with $df = n-2$, $100-2 = 98$, the number of t table is 1.664. The result of t test value (0.859) is less than t table (1.664) with the significantcy levels of 0.393 which is greater than 0.05, thus, it can be concluded that customer satisfaction does

not impact customer loyalty. It means that customer satisfaction on Islamic bank is not high enough to develop customer loyalty.

Table 6. t Test Result of Sub Structure II

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	11.219	2.597		4.320	.000
ISQ	.230	.073	.352	3.138	.002
CS	.044	.051	.096	.859	.393

a. Dependent Variable: CS

To analyse whether customer satisfaction is an intervening variable, or whether there is indirect impacts between Islamic service qualities with customer loyalty through customer satisfaction, Sobel test was used. With 0.05 level of significancy, the result of t test value (0.85) is less than t table (1.96), thus it can be concluded that customer satisfaction in this case is not an intervening variable. It means that there is no indirect impact of Islamic service quality on customer loyalty through or which mediated by customer satisfaction. This also means that customer satisfaction on Islamic bank is not high enough to develop customer loyalty, while the Islamic service quality level of Islamic bank is also not high enough to maintain the customer loyalty, thus, the Islamic bank still has to increase their level of service quality.

Islamic banking provides products and services based on *sharia* (Islamic law) that in practically forbid interest (*riba*) (Kishada and Wahab, 2013; Dahari et.al, 2015; Wahyuni and Fitriani, 2017). Besides financial intermediation, Islamic banks also provide other financial services to create income diversification and added value to their customers. Fee based services that given by Islamic bank to their customers are divided into three groups: financial service, agent and non financial service. *Wakalah* (financial representative), *Kafalah* (guarantee), *Hiwalah* (account receivable transfer), *Rahn* (pawn) and *Sharf* (foreign exchange) are fee based service activities under financial service group. *Mudharabah muqqayyadah* (profit sharing activity) is fee based service under agent group. *Wadi'ah yad dhamanah* (product or money deposit) is fee-based service under non-financial service group (Hardianto and Wulandari, 2016).

To become competitive from the economic perspective, Islamic banking have

structured products that have similar risk-return features of conventional products. While from legal perspective, this is done by using several legitimate Islamic contracts to produce outcomes that replicate conventional products which are compliance with *sharia* (Ahmed, 2014). It is necessary for Islamic banks to have a creative and progressive financial engineering that still offer an efficient and competitive banking system. In fact, Islamic banking industry nowadays is facing very strong competition in technology and communication systems advancement. (Othman and Owen, 2001a; Kishada and Wahab, 2013; Dahari et.al, 2015; Wahyuni and Fitriani, 2017). Therefore just like conventional banks, the superiority in products and service quality is not exception for Islamic banks which will remain sufficient for customer satisfaction and loyalty (Hidayat et.al, 2015).

Based on the descriptive statistical testing, Islamic bank still needs to increase its service quality in order to maintain customer satisfaction and create customer loyalty. It can be done in the following manner. According to the customers, the waiting time is still too long because of some reasons which become serious problems that evoke disappointment and could lead to customer disloyalty. To improve their time management, Islamic banks need to increase the number of teller and customer service counters. According to customers, sometimes even though counters have been added but the number of workforces who served in the teller or customer service are still lacking. This is usually happened to the sub-branch office that has recently increased to a branch office. This means that the management is still delayed in providing additional workforces.

Islamic banks also need to train their workforces to work faster and to be more easily understood when they serve the customers by restoring their standard of procedure with a more effective one so it can suit with the customer needs in order to be able to compete with conventional banks' services which already successfully manage their time management. They also need to be trained intensively and periodically, especially in order to have a deep understanding about Islamic bank products. According to customers, some workforces do not understand about the difference between Islamic bank products with conventional ones.

Another problem is, many Islamic banks still use manual queuing number system which has no longer used by conventional banks. They need to change their obsolete queuing system with an advanced technology which are equipped with modern devices like automatic queuing machine with digital information system. Since Islamic banks operate under different principles and cultures, the latest technology plays a really important role in gaining popularity for the bank among customers (Othman and Owen, 2001b). In addition, Islamic banks should focus on improving their physical facilities in order to overcome negative perceptions and

to enhance their image among customers (Thaker et.al, 2016). When builds a new bank or renovating an existing one, there are brand new considerations that all banks take into account these days. These considerations involve the level of satisfaction the clients and workforces will experience when using the bank's facilities. Several studies have been performed in the immediate environment of leading banks around the world. Many banks are now trying to make their own banking environment as enjoyable as possible for everyone. From the results of these studies, the focus was shifted to combine the requirements of the clients or users with a more pleasurable overall experience when visiting their bank. In this research, the customers suggested that it is necessary for Islamic bank to arrange a more comfortable waiting room with a more comfortable seats.

The Islamic bank location is also a problem, not all branches are located in a strategic area. It means there is still no standardization in setting a new branch location. Thus, the management need to have a standard procedure in establishing a feasibility study before determining the new branch location. According to Weon et.al. (2010), the branches located in the districts of higher degree centrality and closeness centrality had achieved more customers than the branches in the lower degree of centrality and closeness centrality districts. In this research, the customers prefer to choose a branch that is located closed to their offices, shopping centers, their houses, schools or colleges, and easily by passed by public transportations.

Islamic banks also need to expand their networks with an advanced technology and delivery system. The traditional bank delivery system has been the branch network. Modern banks, however, do not rely on the number of its branch network anymore as customers have demands for more advance and convenient delivery systems. Existing literature on banking efficiency usually focus on tangible value creation such as the amount of profit gained or costs reduction. Other aspect such as operation process and system efficiency in the delivery system received little attention (Hooy and Chan, 2014). There has been a revolution with tremendous impact on the banking products and services space with an increase in the usage of mobile gadgets, telecom, and data services at affordable rates, regulated e-commerce platforms assuring security, and the emergence of new market players with growing customer awareness and expectations (Gnanmote, 2017). The use of mobile banking and electronic banking have change the nature of banking activities and provides a lot of other advantages over traditional banking delivery channels. (Hooy and Chan, 2014).

Nowdays, the world of business comprises many companies that use technology as a catalyst to offer various financial services to the end users more efficiently. This is Fintech revolution. Fintech is the abbreviation of financial

technology (Gnanmote, 2017). Fintech has been growing speedily with a global investment reported to be at USD19 billion in 2015, compared to only USD1.8 billion in 2010. The main types of services offered by Fintech are peer-to-peer (P2P) lending, crowdfunding, money transfer, mobile payments and trading platforms. In addition, there are also Fintech services for other sub-segments such as wealth management, insurance, etc (Hasan, 2017).

Fintech in the banking and financial sector normally offer their services in the form of products, applications, business processes, and business models. The target for Fintech in the banking and financial sector are from the consumer and commercial lending and payments space. One of the core businesses of banks and financial institutions is lending and borrowing money. Traditional banks and financial institutions have provided variants of products and services in this area to their customers over the last several years. Fintech entered this business to provide the facility of lending and borrowing money online which was widely accepted by lenders, borrowers, and facilitators across the globe due to its advanced security, access, promotional features, and new customer profiling techniques. The acceptance is not only from customers but also from the regulators promoting them to ensure secured transactions for the lenders on such online platforms (Gnanmote, 2017).

Besides landing and borrowing, banks and financial institutions have been enabling their customers to make numerous payment transactions using their products and services for quite some time. After the technology boom, the area of payments was the most lucrative due to the availability of advanced mobile gadgets, easy access to various data networks, and a wide range of innovative products and applications introduced in the market by Fintech to draw customer attention away from traditional to online platforms. These applications and products with their advanced integration capabilities allow customers to directly partner with merchant vendors and help in removing third-party channels to cut the associated cost for a good customer experience. Many e-wallet providers have collaborated with different industry players of different segments to capture a portion of share in such market revenue (Gnanmote, 2017).

As a non-cash transaction tool, e-money and e-wallet are increasingly in demand by the public including in Indonesia. E-money began to grow in Indonesia in 2007 which is appearing in the form of chip-based that is planted on cards or other media. There are approximately nine chip-based electronic money currently available in the market: Flazz BCA, e-Money Mandiri, Brizzi BRI, Tap Cash BNI, Blink BTN, Mega Cash, Nobu e-Money, JakCard Bank DKI and Skye Mobile Money by Skye Sab Indonesia. While e-wallet or electronic money based on server which currently available in Indonesian market are: T-Cash Telkomsel, XL

Tunai, Rekening Ponsel CIMB Niaga, BBM Money Permata Bank, DOKU, and many more. Based on statistical data in 2017 reported that the value of Fintech transactions has reached 15 billion US dollars. The large penetration of digital technology utilization in Indonesia encourages the government to make the digital economy as one of the government main focus.

Digital technology utilization in financial services create challenges into the way banks currently adapt to innovation. It is not exception for Islamic banking and finance. According to the assistant governor of Malaysia, Marzunisham Omar, the growth of Fintech provides innovative opportunities within the entire financial sector and thus Islamic Fintech cannot be ignored by the Islamic banking and finance industry. In the Islamic finance arena, there are a few prominent Islamic Fintech companies among others include Singapore-based KapitalBoost, Malaysia-based Ethis Kapital Sdn. Bhd. which operates NusaKapital.com and US-based Wahed Invest LLC in the segments of P2P lending and crowdfunding (Hasan, 2017).

Islamic Fintech is still in its early phase; nonetheless, its potential disruptions to traditional Islamic banking and finance should not be underestimated. Market Research Abu Dhabi Report, Abu Dhabi Islamic Bank, the largest *sharia*-compliant lender in United Arab Emirates, announced it is mulling to allocate significant financial capitals on digital technology this year. The move was planned to lower operational costs and increase revenues by having an agile branch network which depends less on humans. Phil King, the head of retail banking at Abu Dhabi Islamic Bank, said that human touch is still largely important and he assured that there will be a hybrid model emerging which is digital with a human touch. Their customers want to be able to do financial transactions digitally but they still want to be able to meet their relationship manager. In line with Abu Dhabi Islamic Bank, according to Sanyalaksana Manibhandu, the head of research at NBAD Securities of Emirates NBD, the Dubai's greatest bank by resources, bank clients are going advanced, so banks need to tilt their item offering to suit computerized channels and create advanced channels. So digitisation with respect to the bank is being driven by client request.

According to IFSB secretary-general, Jaseem Ahmad, there are tremendous opportunities for Islamic Fintech and Islamic banking institutions are taking up Fintech to reach out and improve the attractiveness of their products at a lower cost. Also, the Islamic banking and finance industry currently reaches approximately 100 million customers worldwide, however, the potential market is six times that, and this gap can also be tapped through Fintech (Hasan, 2017). Considering the phenomenon of the emergence of Islamic Fintech in various parts of the world, according to Sugeng, Deputy Governor of Indonesian Central Bank, the

opportunities for Islamic Fintech in Indonesia is quite large. Still, it will take effort from all parties. Several things that need to be concerned is the strengthening of the institutional aspects of Islamic Fintech infrastructure, the application of usefull and efficient Islamic Fintech, the socialization of Islamic Fintech to Islamic financial institutions by Fintech experts, as well as increasing public understanding in general.

As reported by the World Bank, with the presence of Fintech, approximately two billion adults who are currently unbanked will now have access to financial solutions. Moving to the Southeast Asian region, only 27% of the region's 600 million people have a bank account and approximately 40% of the unbanked are Muslims. This serves as an impetus for Islamic Fintech in addressing financial inclusion. With the availability of Shariah-compliant crowdfunding and P2P financing tools, this creates opportunities for individuals and SMEs (Small and Medium Enterprises) who require financing but thus far do not qualify for financing from traditional Islamic banking institutions. For example in the case of Singapore-based Islamic Fintech company of KapitalBoost, it offers SMEs, who are often disadvantaged in their access to funds for business expansion, short-term financing alternatives with fast and friendly approval process and at competitive rates. Financing is provided through Shariah-compliant structures such as *Murabaha*, *Qard*, *Wakalah*, etc (Hassan, 2017).

Overall with Fintech services, it can help the unbanked to create a new form of credit history and moving from there, at the next phase they can then be served by the larger Islamic banking and finance. Middle East region, key Islamic banking and finance jurisdictions such as Bahrain, Dubai and Abu Dhabi sees Islamic Fintech as a huge opportunity. Bahrain has recently partnered with the Singapore Fintech Consorsium to drive Fintech development in the Kingdom. The aim of the partnership is to mainly build the Kingdom into becoming the region's Fintech powerhouse. Other key Islamic banking and finance jurisdiction such as Malaysia also sees Islamic Fintech as an opportunity. According to Al Rajhi Bank Malaysia, Islamic Fintech is seen as an opportunity where with appropriate approach it will help to widen the Islamic banking institutions reach and overcome its network constarians and clients' reach. A successful innovative collaboration between Fintech and Islamic banking institutions in Malaysia is the recent development of the Investment Account Platform (IAP) which is envisaged to become a cross-border multi-currency channel linking into regional and global economies. Parallel to other Fintech platforms such as crowdfunding and peer-to-peer lending, IAP facilitates direct investment by investors in viable ventures of their choices, nonetheless, a key differentiating factor of IAP is the roles undertaken by Islamic banking institutions – it wil provide investors with direct access to a broad range

of investment opportunities, and businesses as well as Islamic banking institutions with a new source of funding (Hasan, 2017).

All in all, Islamic banking institutions including in Indonesia, the country with the largest Muslim population in the world, is expected to add Fintech as their value to serve customer needs. By embracing these themes and creating the right foundations will allow Islamic banks to disrupt their own business model rather than sit on the sidelines watching challenger models disintermediate them. Islamic banks need to create new businesses within their existing structures that adapt and collaborate to meet these challenges and make better use, faster, of their enduring source of competitive advantage.

Conclusion

Customer satisfaction has a very important role to inculcate customer loyalty. In this research, the non-influential customer satisfaction toward customer loyalty indicates that Islamic bank has not been able to build a strong relationship with the customers, thus they still possible to move to another bank which offer better products and services. Indirectly, the Islamic service quality also has no impact toward customer loyalty through customer satisfaction, thus the service quality of Islamic bank has not supported its strategy yet.

This implicates that Islamic bank need to re-develop policies related to the standard of business practices which the bank expects from all of its workforces accordingly to the customers needs. The objective is to make the bank as a professionally run and managed successful and profitable with high standards. Islamic bank still need to make effort to increase the quality of service by improving the workforces' performance through various training programs to increase their abilities in dealings with customers in high standards and to increase their knowledge about Islamic bank products and its system. As the result, they will be able to describe the products and the system better, thus they could maintain customer confidence and satisfaction on the excellence of Islamic bank that is safe and fair which will eventually build a strong customer loyalty.

This research also implicates that the Islamic bank need to re-develop policies related to the standard of procedure or the feasibility study in deciding a strategic branch location before opening a new one. In addition, Islamic bank need to improve its infrastructure in the form of modern buildings and devices including an automatic machine queue with digital information system, a comfortable waiting room with comfortable seats, advance software and hardware, etc, to maintain and improve the efficiency of the operational and managerial of Islamic bank.

Nowadays, the revolution of financial technology (Fintech) in developed and developing countries, has slowly moved from Internet banking to mobile banking and is now taking a new direction toward digital banking. The need for open innovation, collaboration, and investment in the right direction will lead traditional banks to the path of digital banking. Banks should challenge this technological change positively by not being complacent and not just waiting for interest changes from regulators; rather they should work on the key strategies that can redefine banking in this new digital and competitive era. They should find ways and means to collaborate with fintech firms, start-ups, and other market players considering all the financial and regulatory implications that will keep them ahead in the race (Gnanmote, 2017). The growth of Fintech provides innovative opportunities within the entire financial sector, thus it cannot be ignored by Islamic bank. Success or failure of Islamic banking in Indonesia today is depended on its capabilities and policies to anticipate and react the changes in the marketplace fastly. Through Islamic Fintech, financial transactions in Islamic bank will become more automated, user-friendly and more convenient, leading to a higher customer satisfaction and loyalty.

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