CHAPTER 3

Literature Review and Theoretical Framework

- Service Quality
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- Service Quality and Customer Satisfaction in the Banking Sector
- Service Quality, Customer Satisfaction and Bank Performance in the Banking Sector
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Chapter 3

Literature Review and Theoretical Framework

Banks are competing in a highly competitive environment to offer quality oriented services according to customers’ expectations. Islamic banks face stiff competition from their peers and conventional banks prevailing in the economy. Different aspects of banks are studied by researchers e.g. operations, service quality, employee satisfaction, customer satisfaction, financing products, bank efficiency, financial performance etc. as the key segments for research. Many studies tried to assess the quality of services/products offered by the banks. Customers became a center for all banking activities due to increased competition for greater market share. Banks also focus on demographic characteristics of customers to assess their needs. Every bank is trying to enhance its performance by improving its service quality according to customers’ expectations. A number of Islamic banks have started their operations in Pakistan during last few years. It requires a study to analyze the bank services and its outcomes in the shape of customers’ satisfaction and performance.

3.1 Services

This study examines the influence of different dimensions of service quality on the customer's feelings of satisfaction and its influence on bank performance. A model of service quality, customer satisfaction and bank performance is developed in the light of literature to measure the performance of Islamic and conventional banks in Pakistan.
3.1.1 Definition of Service and Service Quality

Business is a legal activity that is undertaken to earn a profit. Business activities can be divided into three categories i.e. manufacturing (conversion of inputs into outputs by a transformation process); trading (buying and selling of goods) and services (provision of benefits for reward or fee). Service is defined as a set of benefits delivered from a service provider to the service consumer. The service firm provides benefits (due to competency, skills, knowledge and experience etc.) to the customers for the sake of reward (fee, salary, wages, etc.). Services may be coaching, teaching, consultancy and other modes to facilitate the customers.

Banks provide financial inter-mediation, consultancy and agency services that are diversified with the passage of time. Services are different from goods because they are intangible as they cannot be seen, touched or felt; perishable as we are unable to store them; inseparable because they are attached with a service provider, and insubstantial due to heterogeneity (Parasuraman et al. 1985; Hoffman and Bateson, 2002).

Parasuraman et al. (1985) argued that evaluation of service quality is difficult as compared to physical goods. Physical existence of goods facilitates the customers to buy them due to its aesthetic characteristics. Services are considered as intangible because we are unable to see, touch or feel them (Hoffman and Bateson, 2002).
Hanson (2000) suggested that service quality shows the organization's ability to meet customers' desires and needs. So organization must improve their services to meet the customers' wants and requirements. It is found that customers' perception of service quality is very important for managers to compete in the market (Hoffman and Bateson, 2002).

Quality is an ability of any product to meet customers' expectations and requirements. It is a set of features, characteristics or attributes that are required or expected by the customers. There are several studies that found a relationship between the service quality offered by banks and its consequences as satisfaction level among customers. It is reported that quality is observed as a major factor in reference to customer acquisition and retention (Galloway and Ho, 1996).

Morre (1987) identified that concentration on service quality leads to differentiation that enhance the competitive position of the organization for long term benefits. Service quality and customer satisfaction became core issues for the successful survival of any service organization. Service quality is considered very important indicator towards customer satisfaction (Spreng and Machoy, 1996). Service quality got popularity among professionals and academia due to increased competition. It contributes a lot to gain competitive advantage to maintain long-term relationship with customers (Zeithmal et al. 2000)
There are two perspectives regarding service quality i.e. one is European and other is Americans. European researchers concentrate on functional and technical aspects of services having a keen analysis of organization's image (Gronroos, 1982, 1984; Lehtinen and Lehtinen, 1982). They focus on three dimensions of service quality to measure the performance of any product by considering functional quality, technical quality and corporate image. Service quality is defined as a discrepancy between expected and perceived service. It is said that service quality is the outcome of customers' comparison between expectations and performance (Gronroos, 1982).

The Americans' perspective is concentration on functional quality to measure the performance of services (Parasuraman et al. 1985, 1988, 1991; Kang and James, 2004). They investigated the service quality of different industries by dividing the service quality into five dimensions: tangibility, reliability, responsiveness, assurance and empathy. Firstly, they identified ten dimensions but finally service quality is refined to five dimensions (Parasuraman et al. 1985, 1991).

Parasuraman et al. (1985, 1988) defined service quality as customers' evaluation between service expectation and service performance. They compared customers' responses regarding their perceived quality of services and their pre-purchase expectations. It is said that service quality represents the answers to some queries like what is expected by customers? What is delivered? Finally is there any difference? (Woodside et al, 1989).
Asubonteng et al. (1996) defined service quality as the difference between customers' expectations about the service before its use and their perceptions after receiving the service. Quality factors vary from one to another in reference to the importance and their impact on the satisfaction level of the customers. It was found that specific activities like increasing the speed of processing information have resulted in delighted customers. Similarly, improvement in the reliability of equipment lessened dissatisfaction (Johnston, 1997). However, it was reported that service quality is the subjective comparison between what the customers require and what they actually get (Gefan, 2002).

Ibáñez et al. (2006) investigated service quality dimensions and found a significant effect of service quality on satisfaction in Spain. In another study, a conceptual framework to measure service quality from the customer's perspective is empirically tested for convergent validity, uni-dimensionality and reliability (Saravanan and Rao, 2007).

### 3.1.2 Dimensions of Service Quality

There is an ongoing discussion about the service quality and its dimensions. But there is a lack of consensus in the literature about the uniform dimensions among researchers. It may be due to demographics, cultural, religious, geographical or other attributes that vary form one country to another. Apparently, there are two perspectives of service quality: Europeans and Americans. Service quality is a multilevel and multidimensional concept, which varies in meanings among researchers (Cronin et al., 2000).
Gronroos (1982) identified three dimensions of service quality as technical quality (actual outcome of the service); functional quality (service delivery process by interaction between service provider and service recipient); and corporate image (perception of customers about service organization). Similarly, in another study three dimensions of service quality are identified i.e. physical quality; corporate quality and interactive quality (Lehthinen and Lehthinen, 1982). Both studies reflect almost the same characteristics of the service quality.

Parasuraman et al. (1985) investigated the different service industries and explored 10 dimensions of service quality i.e. tangibility, responsiveness, reliability, courtesy, access, credibility, communication, competence, understanding, and security. They continued their research to purify the dimensions of service quality and developed a widely used research instrument called SERVQUAL. It is equally applicable in different service industries including banking industry. They refined these dimensions and summed up into five dimensions like reliability, responsiveness, tangibility, assurance and empathy (Pararsuraman et al. 1988, 1991).

Gronroos (1990) explored six factors of service quality: attitude and behavior; skills and professionalism; accessibility and flexibility; reliability and trustworthiness; recovery; reputation and credibility. In another study, a four-factor scale that consists upon 17 items was used to measure service quality in branches of an Australian commercial bank (Avkiran, 1994).
Johnston (1995) identified 18 dimensions of service quality to measure the performance of service industries: aesthetic, availability, attentiveness, access, care, cleanliness, comfort, commitment, communication, competence, courtesy, friendliness, flexibility, functionality, integrity, reliability, responsiveness and security. Oppewal and Vriens (2000) used 28 attributes to measure the service quality in retail banking sector. Similarly, Bahia and Nantel (2000) found six dimensions of service quality that consists of 31 items to measure the service quality in the banking sector.

Sureshchander et al. (2002) developed 41 items scale to measure the service quality in the banking sector. Although there are different dimensions of service quality exist in the literature. But this study follows SERVQUAL instrument based on five dimensions to measure the impact of service quality on customer satisfaction and bank performance.

Parasuraman et al. (1985, 1988, 1991b) tested this research instrument in different industries like banking, insurance and telephone repair industry. The reliability and validity coefficients of SERVQUAL were very high and increased its acceptability all over the world. It is also widely used by the researchers to assess the service quality in the banking sector. The dimensions of service quality are frequently studies by the researchers according to their own local environment, cultural and socioeconomic conditions. There are numerous studies that identified a number of dimensions due to lack of global dimensions. A list of service quality dimensions used in the banking sector across the globe is given in table 3.1.
Table-3.1

*Dimensions of Service Quality used in Banking Sector*

<table>
<thead>
<tr>
<th>Year</th>
<th>Author(s)</th>
<th>Dimensions Service Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1982 Gronroos</td>
<td>Suggest three dimensions of service quality: technical quality; functional quality; corporate image</td>
</tr>
<tr>
<td>2</td>
<td>1982 Lehthinen and Lehthinen</td>
<td>Identified three dimensions of service quality: physical quality; corporate quality and interactive quality</td>
</tr>
<tr>
<td>3</td>
<td>1984 Gronroos</td>
<td>Refined their previous work and elaborate three dimensions of service quality</td>
</tr>
<tr>
<td>4</td>
<td>1985 Parasuraman <em>et al.</em></td>
<td>Identified ten dimensions of service quality: reliability; responsiveness; tangibility; courtesy; access; credibility; communication; competence; understanding; security</td>
</tr>
<tr>
<td>5</td>
<td>1987 Morre</td>
<td>Service quality leads to differentiation and enhance competitive position</td>
</tr>
<tr>
<td>6</td>
<td>1988 Parasuraman <em>et al.</em></td>
<td>Refined their previous work and compiled ten dimensions of service quality into five: reliability; responsiveness; empathy; assurance; empathy</td>
</tr>
<tr>
<td>7</td>
<td>1990 Gronroos</td>
<td>Explored six dimensions of service quality: attitude and behavior; skills and professionalism; accessibility and flexibility; reliability and trustworthiness; recovery; reputation and credibility</td>
</tr>
<tr>
<td>8</td>
<td>1991 Parasuraman <em>et al.</em></td>
<td>Refined five dimensions of service quality and replicate in three service industries i.e. banking, telephone repairing and insurance and devised final version of SERVQUAL</td>
</tr>
<tr>
<td>Year</td>
<td>Authors</td>
<td>Details</td>
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<tr>
<td>1992</td>
<td>Cronin &amp; Taylor</td>
<td>Developed SERVPERF to compare with SERVQUAL</td>
</tr>
<tr>
<td>1994</td>
<td>Avkiran</td>
<td>Developed four factor scale that consists of seventeen items to measure Service quality</td>
</tr>
<tr>
<td>1995</td>
<td>Johnston</td>
<td>Identified eighteen dimensions of service quality: aesthetic; availability; attentiveness; access; care; cleanliness; comfort; commitment; communication; competence; courtesy; friendliness; flexibility; functionality; integrity; reliability; responsiveness; security.</td>
</tr>
<tr>
<td>2000</td>
<td>Oppewal and Vriens</td>
<td>Explored twenty eight attributes to measure service quality</td>
</tr>
<tr>
<td>2000</td>
<td>Bahia and Nantel</td>
<td>Developed six dimensions of service quality that consists of thirty one items</td>
</tr>
<tr>
<td>2002</td>
<td>Sureshchander et al.</td>
<td>Developed five dimensions of service quality that consists of forty one item scale</td>
</tr>
<tr>
<td>2005</td>
<td>Malhotra et al.</td>
<td>Used 10 dimensions to measure service quality</td>
</tr>
</tbody>
</table>

Source: Generated

Parasuraman et al., (1988, 1991) developed SERVQUAL instrument to measure the dimensions of service quality that is frequently used by researchers. It consists of 22 items that are compiled into five dimensions: tangibility; reliability; responsiveness; assurance and empathy. This study applied five dimensions of service quality that are explained as under:
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Reliability— This dimension shows the consistency of services towards performance and dependability.

Tangibles— It shows the physical aspects of the services as physical facilities, appearance of personnel and tools & equipment used for provision of services.

Responsiveness— It reflects the willingness or readiness of employees to provide quick services to customers.

Assurance— This dimension indicates the employees’ knowledge, courtesy and their ability to incorporate trust and confidence.

Empathy— This dimensions shows the magnitude of caring and individual attention given to customers.

3.1.2.1 Reliability

Reliability is the ability to perform services dependably and accurately in a consistent manner. It contains five elements to assess the accuracy and credibility of bank services. This dimension of service quality evaluates the promises of banks and its execution from customers' point of view. Reliability is very important determinant of product quality besides good personal service, staff attitude, knowledge and skills (Walker, 1990).

Berry and Parasuraman (1991) reported that reliable service is the outcome of the continuous improvement. Similarly in another study, it is found that service reliability is the service “core” to most customers. So managers should use every opportunity to build a “do-it-right-first” attitude (Berry et al., 1990).
3.1.2.2 Tangibility

This dimension shows the physical aspects of the services as physical facilities, appearance of personnel and tools used for the provision of services. It is more concerned with aesthetic part of the banks. It is found that customers prefer tangible dimension of service quality in UAE banking industry (Jabnoun and Al-Tamimi, 2003).

Zineldin (2005) studied the product/service quality and customer relationship factors in Sweden. It is found that a bank can create customer relationships by delivering added tangible and intangible elements of the core products. Strong competitive positions are the outcome of product/service quality and differentiation.

3.1.2.3 Responsiveness

This dimension reflects the willingness or readiness of employees to provide quick services to customers. Customers are very keen to employees' behavior in services industry especially in the banking industry. It was reported that customers are very sensitive to employees' working environment in service organizations (Brown and Mitchell, 1993). It was found that correct match between staff skills and customers' expectation resulted in better service quality towards customers (Gollway and Ho, 1996). Service recovery and problem solving have been recognized as important parts of services quality (Hart et al., 1990; Dabholkar et al., 1996; Swanson and Kelley, 2001; Nelson and Chan, 2005).
Tahir and Abu Bakar (2007) investigated service quality and customer satisfaction of commercial banks by using SERVQUAL in Malaysia. They found that responsiveness is rated as the most important dimension of service quality. It was found that accurate communication, proper service delivery and effective conflict handling results into overall customer satisfaction regarding bank services in Malaysia (Nelson, 2006).

3.1.2.4 Assurance

This dimension indicates the employees' knowledge, courtesy and their ability to convey trust and confidence. Service quality is also linked to the customer satisfaction as how employees use their knowledge & courtesy and their ability to incorporate trust and confidence. Parasuraman et al. (1988) reported assurance as an essential dimension of service quality after reliability and responsiveness towards satisfaction. It is found that a bank can create customer satisfaction by ensuring trustworthy behavior and reflection of genuine commitments to service provision (Nelson and Chan, 2005).

Arasli et al. (2005) identified that assurance dimension of service quality has the strongest impact on customer satisfaction that leads to positive word of mouth outcome. In another study, overall customer satisfaction was examined in reference to relationship quality in retail banking sector of Malaysia. The results indicated that trust and commitment are important factors for customer satisfaction regarding relationship quality (Nelson, 2006).
3.1.2.5 Empathy

This dimension shows the magnitude of caring and individual attention given to customers. In the banking sector customer care and individual attention is indispensable for the better performance due to stiff competition. Bank customers considered empathy as an important dimension of service quality (Jabnoun and Al-Tamimi, 2003). It is suggested that employees' commitment to deliver quality services, skillfully handling of conflicts and efficient delivery of services resulted in satisfied customers for long term benefits (Nelson and Chan, 2005).

Malhotra et al. (2005) examined the difference in perceptions of service quality dimensions between developing and developed countries. They found that in developing countries like India and Philippines results were systematically and significantly different. It is found that empathy is least preferred dimension of service quality by the customers of commercial banks in Malaysia (Tahir and Abu Bakar, 2007).

Parasuraman et al. (1991) reported reliability is largely concerned with the service outcome while others related to the service process. Leeds (1992) reported that service quality primarily depends upon the dealings of bank personnel. It was found that approximate 40% of customers switched their current bank due to poor services and nearly three quarters of banking customers gave the highest preference to tellers' courtesy. Customers of private banks have higher expectations and perceptions as compared to the customers of public banks in Greece (Kangis and Voukeates, 1997).
Longo (2000) suggested that bank managers should be more aware about the significance of quality improvement efforts to gain competitive position in the market. The results of these efforts are slow and sometimes have little influence. Customers' perception of service quality is strongly dependent on customers' values and beliefs that vary from one culture to another (Furer et al., 2002).

Gounaris et al. (2003) explored the service quality in Greek banking industry. The study showed that the magnitude of the influence of each dimension of service quality on customer satisfaction is considerably differs. It is reported that technological factors of service quality are more important as compared to human factors of service quality in Indian banking industry (Sureshchander et al., 2003). It is said that there is direct and positive relationship between perceived quality and level of satisfaction (Iglesias and Guille´n, 2004). Similarly, it was found that expectations of bank customers were not met due to major gap in the empathy dimension. On the other hand, assurance has significant impact on the customer satisfaction of bank customers (Arasli et al., 2005).

Jabnoun and Khalifa (2005) proposed a measure of service quality and then tested it in conventional and Islamic banks in UAE. They found that four dimensions: personal skills, reliability, values, and image are significant in case of conventional banks. While only personal skill and values were found significant in Islamic banks. Similarly, service quality is examined by conducting a survey of 300 bank customers in Thailand. The study depicted that reliability; serviceability and durability are the most important dimensions of service quality in the banking sector (Leelapongprasut et al., 2005).
Al-Hawari and Ward (2006) found that customer satisfaction plays an inter-mediator role in the relationship between service quality and financial performance of the banks in Australia. An empirical study was conducted in UAE banking sector to investigate the service excellence. It found a positive relationship between service quality and satisfaction (Liang and Wang, 2006).

Glavell et al. (2006) conducted an empirical analysis of customers from five Balkan countries: Greece; Bulgaria; Albania; FYROM and Serbia. The study investigated the customers' views towards service quality offered by banks. It was found that there is a significant difference in customers' perceptions of service quality in different countries. Greek customers have highest perceptions towards service quality. It is suggested that service quality should be ensured by implementation of total quality management techniques in the banking sector (Al-Marri, Ahmad and Zairi, 2007).

It is evident that political, technological, environmental and socioeconomic factors influence the service quality perceptions of customers. Service quality offered by banks is examined by a comparative study of Bulgarian and Greece banks. The study suggested that there is a difference about the perception of service quality among customers of different countries. Findings show that Greece customers have higher levels of service quality perceptions as compared to Bulgarian customers (Petridou et al., 2007). Customers perception of service quality could be affected by the demographic features of the customers especially gender. It is concluded that gender influences the customer perception of service quality in the banking sector (Spathis et al., 2004).
3.2 Customer Satisfaction

Financial sector has shown unprecedented growth after deregulation in Pakistan. Pakistani financial markets experienced drastic changes after financial liberalization during early 1990s that provokes tough competition among financial institutions especially in banking sector. This competition leads to the introduction of customer-oriented products in the market to meet the expectations of customers.

3.2.1 Definition of Satisfaction

Satisfaction means a feeling of pleasure because one has something or has achieved something. It is an action of fulfilling a need, desire, demand or expectation. Every rationale customer compares the cost (price) and benefit (utility) of any product or services. Customers compare their expectations about a specific product/services and its actual benefits. This comparison results into three types of customers: dissatisfied customers (expectations are more than actual performance of the service); satisfied customers (actual benefits realized from services are equal to or more than expectations); indifferent customers (actual performance and expectation are exactly equal).

Westbrook (1981) reported that overall satisfaction is the outcome of customer's evaluation of a set of experiences that are linked with the specific service provider. It is observed that organization's concentration on customer expectations resulted into greater satisfaction (Peters and Waterman, 1982). Kotler (2000) defined satisfaction as a
person's feelings of pleasure or disappointment resulting from the comparison of product's perceived performance in reference to expectations. Customers' feelings and beliefs also affect their satisfaction level. It is said that satisfaction is a function of customer's belief about fair treatment (Hunt, 1991).

Customer satisfaction has become important due to increased competition as it is considered very important factor in the determination of bank's competitiveness (Bartell, 1993; Haron et al. 1994). Satisfaction is a post purchase evaluative judgment associated with a specific purchase decision (Churchil and Suprenant, 1992). The customer satisfaction is indispensable for the successful survival of any organization. Continuous measurement of satisfaction level is necessary in a systematic manner (Chakravarty et al. 1996; Chitwood, 1996; Romano and Sanfillipo, 1996).

3.2.2 Customer Satisfaction in Banking

Financial liberalization and deregulation has increased the competition among banks to attract potential customers. Every banker tries to provide superior services to keep satisfied customers. In Pakistan, emergence and growing popularity of Islamic banking products raises competition among Islamic banks. Islamic banks have to face numerous challenges in the recent age. Firstly, they are competing with their peers and secondly they have to cope with the conventional banks. Customer satisfaction is a set of feelings or outcome attached with customer's experience towards any product/service (Solomon, 1996).
Yi (1990) defined customer satisfaction as a cumulative outcome of perception, evaluation and psychological thinking of customers when they utilize any service. There are a number of studies that measured the customer satisfaction towards services in the banking sector (Anderson et al., 1993; Brenhardt et al., 1994; White, 1994; Bedal and Power, 1995; Holliday, 1996; Dispensa, 1997).

Satisfied customer is the real asset for any organization that ensures long-term profitability even in the era of great competition. It is found that satisfied customer repeat his/her experience to buy the products and also creates new customers by communication of positive message about it to others (Dispensa, 1997). On the other hand, dissatisfied customer may switch to alternative products/services and communicate negative message to others. So, organizations must ensure the customer satisfaction regarding their goods/services (Gulledge, 1996).

Figure-3.1

*Expectation-Outcome Experience of Customers*

Source: Generated
Figure 3.1 reflects expectation-outcome experiences of customers among bank customers. Customer satisfaction leads to better profitability by retaining existing customers and to attract new ones. Every organization deploys a reasonable amount to have satisfied customers. Satisfied customer leads to delighted customers that eventually create the sense of brand loyalty among customers.

The sequence of customer satisfaction in reference to satisfied customers, delighted customers and loyal customers can be expressed in figure 3.2.

Figure-3.2

*Customer Satisfaction for better Performance*

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Cost (Price) = Expectation (Benefits)

Satisfied Customers

Delighted Customers

(Customers) Brand Loyalty

Greater & Long-term Profits
(Better Performance)
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Source: Generated
Organization should convey an attractive message to their customers about their product mix on rationale basis because exaggeration and unrealistic promises may result in dissatisfaction among customers. Customer satisfaction is an urgent challenge for Islamic banks as it was considered in case of conventional banks. Customer satisfaction became the center of organizational efforts. Financial institutions have experienced an intense competition and changing expectations of the customers (Cheng et al. 1996).

### 3.2.3 Determinants of Customer Satisfaction

Banking industry expanded over a number of years due to the introduction of new products and services. It may be due to an increasing number of new foreign and local banks and their working pattern as conventional banks or Islamic banks. Both streams of banks are striving to attract the potential customers at any cost. This increased competition requires the provision of quality services to have satisfied customers for sustainable benefits. It is reported that delivery of high quality services is the key to sustain competitive advantage to have satisfied customers (Shemwell et al., 1998).

Customer satisfaction is the central tenet to compete in the market successfully. It is prerequisite to retain customers to generate economic benefits. Customer satisfaction is crucial to realize greater profitability, larger market share and more returns on investments etc. (Scheuing, 1995; Reichheld, 1996; Hackl and Westlund, 2000). Customer satisfaction is a multidimensional construct that requires multi-item scale for its measurement. Researchers agree with the multidimensional nature of customer
satisfaction and measured it accordingly (Westbrook and Oliver, 1981; Crosby and Stephens, 1987; Supernant and Soloman, 1987; Oliver and Swan, 1989; Oliva et al. 1992; Bitner and Hubert, 1994; Shemwell et al., 1998; Sureshchander et al., 2002).

Cronin and Taylor (1992) used a single item scale to measure the customer satisfaction. They asked customers to report overall feeling of satisfaction regarding a specific service experience. This approach proved insufficient due to concentration on only one item. Customers' overall satisfaction is investigated by using a four-item scale with reference to service provider (Bitner and Hubert, 1994). Another study investigated customers' satisfaction by developing a five-item scale to test their model (Shemwell et al., 1998). Similarly, customer satisfaction was investigated in banking sector by using a six-item scale (Prince et al., 1995).

Sureshchander et al. (2002) investigated customer satisfaction by using a forty one-item scale that is further summed up into five dimensions. They investigated the relationship between service quality and customer satisfaction in the banking industry. They suggested five dimensions of customer satisfaction i.e. core service or service product; human element of service delivery; systematization of service delivery (nonhuman element); tangibles of service (servicescapes) and social responsibility.

Customer satisfaction appears as the cumulative result of customer’s internal feelings about their experiences related to products/services. It is suggested that organizations especially banks should concentrate on customer satisfaction. It could result into repeated

Metawa and Almossawi (1998) investigated the banking behavior of Islamic banking customers in Oman by collecting data from 300 customers. They aimed to find out the awareness and satisfaction level among customers of Islamic banks by considering their demographic data. The findings showed that the most of the customers are highly satisfied with products and services of Islamic banks. They suggested that bankers should develop professionalism and competency to maintain profitable relations with customers.

Naseer, Jamal and Al-Khatib (1999) examined customer awareness and satisfaction by using a sample of 206 respondents towards Islamic banking in Jordan. They found customer awareness about Islamic bank products like Murabaha, Musharka and Mudarba but expressed a sense of dissatisfaction towards some of the services provided by Islamic banks. It is investigated that how customer satisfaction affects the customers' behavioral consequences. The findings showed a strong impact of customer satisfaction on their decision to stay with the existing service provider and restrain their negative behavioral intentions. It is reported that there is a positive association between customer satisfaction and word of mouth communication (Athanassopoulos et al., 2001).
Khalifa and Liu (2003) said that satisfaction is measured by the discrepancy between perceived performance and cognition like expectations or desires. There are several factors that yield customer satisfaction but service quality is one of them. It is reported that customer satisfaction helps to retain customers for greater profitability, increase in market share and more return on investment (Hackle and Westlund, 2000). It is investigated that service quality works as input to appear as customer satisfaction (Malta, 2002). It is found that customer satisfaction generates several outcomes like repeat purchase; loyalty, positive word of mouth and long term profitability (Wirtz, 2003).

Gustafsson (2005) defined satisfaction as a customer's overall evaluation pertaining to offer. The study found that overall satisfaction has a strong positive impact on customer loyalty regarding a wide range of products and services. It is explored that there is direct and positive relationship between perceived quality and level of satisfaction (Iglesias and Guille’n, 2004). It is suggested that the bank can create customer satisfaction by incorporating trustworthy behavior, proper communication of information, reflection of genuine commitment to provide quality services, settlement of conflicts and improvement in the quality of overall customer relations (Nelson and Chan, 2005).

Ting (2006) investigated the impact of customer satisfaction in Malaysian banking industry and found a U-shaped relationship between customers' perception of satisfaction and positive word of mouth referrals in the existence of changing ownership. Structural equation modeling is one of the statistical tools applied to measure customer satisfaction. The study was based on 220 customers from 15 retail banks. It was found that overall
customer satisfaction is the key determinant of relationship quality. The main indicators of customer satisfaction were listed as trust, commitment, communication, service quality, service satisfaction and service handling (Nelson, 2006).

Cohen et al. (2006) investigated the customer satisfaction in the banking sector in New Zealand. Findings showed that customer satisfaction is the most important factor that influences customer decisions. Customers' age groups and educational level also contributed to their decision whether to stay with a current bank or not. It is evident from a survey of 230 retail-banking customers that responsiveness and reliability showed greatest impact on customer satisfaction in United States (Lopez, Hart and Rampersad, 2007).

Molina, Martý and Esteban (2007) investigated the customer satisfaction in retail banking by an empirical analysis of 204 bank customers. They found a direct relationship between confidence benefits and customer satisfaction. Norizan and Nizar (2007) investigated perceived service quality and satisfaction as a key determinant for retention of customers in retail banking in United Arab Emirates. They found that satisfaction is important for retention of retail banking customers in UAE. It was found that supplier-customer relationships are critical in banking sector for delivery of quality services to have loyal customers for long-term profits (Ndubisi et al., 2007).
3.3 Bank Performance

Organization is a structured entity that is established to achieve specific goals. It consists of physical, human, informational and financial resources that are combined to realize certain objectives. Business organization is primarily formed for the sake of profit by performing legal activities. Bank is also one of the business organizations that offer a large number of products and service for profit. Organization as it is goal oriented, boundary-maintained and socially constructed systems of human activity (Aldrich, 1979). Every organization is trying to enhance the performance of individuals for overall improvement of the whole organization. Performance evaluation enables the organization to assess its efficiency and effectiveness over a period of time by comparing with its objectives or with market leader to overcome its weaknesses. Researchers explored a number of indicators to measure organizational performance (Dess & Robinson, 1984).

There are several criteria to evaluate the performance of banks for successful survival in the era of globalization and competition. Multiple aspects like profitability, liquidity, management performance, leverage, market share, productivity, innovation, quality of products, human resources and sales volume etc. can evaluate any organization. Inception of Islamic banks necessitated the importance of performance evaluation to compete with conventional banks in Pakistan.

Tvorik and McGivern (1997) investigated performance by comparing economic and organizational factors. They concluded that organizational factors influenced the profitability more than that of the economic factors. Successful organizations realized the
importance of ongoing performance measurement practices (Weiss and Hartle, 1998). Organization's performance could be assessed by resource-based view as explored by a number of researchers (Wernerfelt, 1984; Barney, 1986 a,b; Prahalad and Hamel, 1990). It may be shown by varied combination in the literature. Organizational performance could be linked with market orientation, organization learning, human resource productivity, quality improvement or any other component (Day, 1994; Banker and Sinkula, 1999; Santos-Vijande et al., 2005).

Organizational performance reflects an organization's understanding and knowledge regarding customer needs and expectations (Kohli and Jaworski, 1990; Deshpande et al., 1993; Slater and Narver, 1995). It is reported that an organization can maximize the customer satisfaction for better profitability, increased sales volume that ultimately improves its performance for long term benefit (Baker and Sinkula, 1999). Generally, organizational performance is assessed by the application of financial measures. There are a number of studies in the literature that used non-financial measures to evaluate the effectiveness and performance of organization (Quinn and Rohrbaugh, 1983; Venkatramanand, 1986). It is suggested that four models i.e. human relations; internal process; open system and rationale goal model could represent the organizational performance (Quinn and Rohrbaugh, 1983).

Wheelen and Hunger (1998) argue that appropriate performance measures depend on the organizations and their objectives i.e. profitability, market share and cost reduction. Financial indicator like return on investment (ROI), earning per share (EPS) and return
on equity (ROE) etc. are used by number of organizations to measure their progress. Return on investment is used to reflect the profitability while corporate performance was measured by operating cash flows and return on investment capital (Sorenson, 2002).

Rashid et al. (2003) measured firm's financial performance using the financial indicators such as return on assets, return on investments and current ratios. Financial ratios reflect the financial performance of the organization by an examination of financial statements as indicated by profitability, liquidity, leverage, asset utilization and growth ratios (Ho and Wu, 2006). The relationship between organizational innovation and performance was investigated by application of return on sales, return on assets, return on equity and market-to-book ratio (Kuo and Wu, 2007).

### 3.3.1 Performance Evaluation of Islamic Banks

Islamic banks are competing for more customers with each other besides stiff competition with conventional banks. There are several measures that were adopted by the researchers to assess the bank performance like profitability, liquidity, management performance, market share, sales volume, innovation, productivity, human resources, quality of goods and service etc. There are different qualitative and quantitative tools that are used to measure the bank performance. The measure of performance evaluation should be meaningful. It reflects management's clarity about organization's current situation and its viability to achieve its goals. It should be manageable as it can be handled easily based on simple calculations and manipulation of data. It must be measurable as it should be
quantifiable and operationalized. It may be material, as it should provide material results of significant improvement (Ernst & Young, 1995).

Chapman et al. (1997) examined the influence of quality on the performance of an organization. The study measured the organizational performance using financial ratios such as earnings on shareholders funds, return on total assets and labor productivity ratio. It is found that there is a positive relationship between strategic quality indicators and financial performance parameters. It is reported that employees of domestic banks do not contribute towards profitability. But employees of foreign banks significantly contributed towards profitability (Arby, 2003).

### 3.3.2 Performance of Pakistani Banking Sector

Pakistani banking sector has shown an excellent growth during last few years. Financial performance of banking sector was outstanding due to sufficient profitability, strong solvency, assets management quality, better risk management practices and continuous improvements for the provision of quality services. Total banking assets surpassed the limit of Rs. 4 trillion along with Rs. 100 billion pretax profits. Islamic banks also experienced unprecedented growth by a 67% increase in total assets of this segment. Islamic banking system has proved a successful alternative for the conventional banking system (SBP, 2007).
The performance of Pakistani banking system from a period of 2000-2006 is shown in figure 3.3 as under:

Figure-3.3

*Total Assets of the Banking System*

<table>
<thead>
<tr>
<th>CY</th>
<th>Rs in Billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>CY00</td>
<td>902</td>
</tr>
<tr>
<td>CY01</td>
<td>947</td>
</tr>
<tr>
<td>CY02</td>
<td>878</td>
</tr>
<tr>
<td>CY03</td>
<td>959</td>
</tr>
<tr>
<td>CY04</td>
<td>653</td>
</tr>
<tr>
<td>CY05</td>
<td>724</td>
</tr>
<tr>
<td>CY06</td>
<td>836</td>
</tr>
<tr>
<td>PSCBs</td>
<td></td>
</tr>
<tr>
<td>LPBs</td>
<td></td>
</tr>
<tr>
<td>FBs</td>
<td></td>
</tr>
<tr>
<td>CBs</td>
<td></td>
</tr>
<tr>
<td>SBs</td>
<td></td>
</tr>
<tr>
<td>All</td>
<td></td>
</tr>
</tbody>
</table>

CY: Calendar Year; PSCBs: Public Sector Commercial Banks; LPBs: Local Private Banks; FBs: Foreign Banks; CBs: Commercial Banks; SBs: Specialized Banks

Source: SBP, 2007

Islamic banks are successfully competing with conventional banks around the globe and have a great potential to replace the traditional Riba-based banking system. In Pakistan, the Islamic banks showed a very satisfactory growth during last few years having a complete alternative banking system. A very healthy competition is witnessed between the two banking streams that reflect the superiority of Islamic banks as they are growing...
at a rate of 114 percent in terms of size and structure. The total assets are growing at a very favorable rate of 67% with deposits amounting Rs. 83.7 billion (SBP, 2007). Progress of Islamic banks in Pakistan is shown in the table 3.2.

Table-3.2

Sources & Uses of Funds by Islamic Banks in Pakistan (2003-06)

(Million Rs.)

<table>
<thead>
<tr>
<th>Sources</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amou</td>
<td>Percent</td>
<td>Amou</td>
<td>Percent</td>
</tr>
<tr>
<td>Deposits</td>
<td>8397</td>
<td>65</td>
<td>30185</td>
<td>68</td>
</tr>
<tr>
<td>Borrowings</td>
<td>1899</td>
<td>15</td>
<td>6559</td>
<td>15</td>
</tr>
<tr>
<td>Capital &amp; Other Funds</td>
<td>1994</td>
<td>15</td>
<td>5123</td>
<td>12</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>625</td>
<td>5</td>
<td>2276</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12915</strong></td>
<td><strong>100</strong></td>
<td><strong>44143</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

| Uses                           |        |        |        |        |
| Financing                      | 8652   | 67     | 27535  | 62     | 45786  | 64     | 65613  | 55     |
| Investments                    | 1242   | 10     | 2007   | 5      | 1854   | 3      | 7328   | 6      |
| Cash, Bank Balance, Placements | 1978   | 15     | 11900  | 27     | 19314  | 27     | 31358  | 26     |
| Other Assets                   | 1042   | 8      | 2701   | 6      | 4539   | 6      | 14996  | 13     |
| **Total**                      | **12915** | **100** | **44143** | **100** | **71493** | **100** | **119294** | **100** |

Source: SBP, 2007
In today's global, dynamic and competitive environment banks should improve and diversify their products and services to meet changing customers' demands to enhance their performance for successful survival. There are a few studies available in the literature that measured the performance of Islamic banks across the global. Performance measurement became indispensable for the successful survival banks due to stiff competition and customers' awareness of service quality. It is reported that Pakistani banking sector has shown good performance by attracting a large number of customers due to the provision of quality services (Arby, 2003).

Dick (2003) examined the service quality and bank performance in the United States. Deregulation increased the branch network of banks to attract more and more customers that resulted into more profits with increased risks due to changing demographics. Findings showed that improved service quality resulted in increased service fee and risk could be reduced by geographical diversification and hedging. It is reported that two principle paths can improve financial performance of banks i.e. by improving operational efficiency or improvement in customer services (Duncan and Elliott, 2004).

Dick (2005) reported that market concentration is not affected by its size. Dominant banks have almost similar influence on markets of different size. The study found that service quality is enhanced and focused by dominant banks. Performance evaluation provides sufficient information to take better and informed business decisions. Better decisions results more profitability and improved performance for the institution and its shareholders (Crider, 2007).
3.4 Service Quality and Customer Satisfaction in Banking

Islamic banks showed remarkable progress. It has captured a reasonable market share with excellent growth rate of 114% per annum. The increasing number and size of Islamic banks is also a positive sign of development and success. There are six full-fledged Islamic banks working in different cities of Pakistan and 13 conventional banks have started partial Islamic banking practices by establishing a large number of branches exclusively engaged in Islamic banking practices (SBP, 2006).

Mishkin (2001) reported that banking and financial services are the integral part of services industry and its contribution is increasing with the passage of time. However, expansion of global and integrated banking sector has to face many challenges of legislation, technological and structural changes (Angur et al. 1999). The relationship between service quality and customer satisfaction is investigated by a number of researchers across the globe. It is concluded that there is strong association between dimensions of service quality and overall customer satisfaction (Anderson and Sullivan, 1993). It is found that the banking industry has a link between service quality and customer satisfaction (Avkiran, 1994). Islamic banking practices resulted a notable increase in the supply of loans. It is found that government intervention played an important role to manage funds besides other economic factors in the economy (Makiyan, 2003).
Levesque and McDougall (1996) investigated the influence of key determinants of service quality on customer satisfaction in financial institutions. They found a substantial impact of service problems on customer satisfaction and their intentions to switch. It is suggested that service quality is an essential determinant of customer satisfaction (Yavas et al., 1997). Islamic banks working in different parts of the world assessed their performance in reference to service quality and customers' responses. An empirical study was conducted to measure customer awareness and satisfaction by using a sample of 206 respondents towards Islamic banking in Jordan. It is observed that customers have awareness about products of Islamic bank but expressed a sense of dissatisfaction towards some of the services (Naseer, Jamal and Al-Khatib, 1999).

Bahia and Nantel (2000) developed an alternative scale for measurement of service quality in retail banking. They developed BSQ and compared with SERVQUAL. They found that BSQ dimensions are more reliable than SERVQUAL dimensions. In another study SERVQUAL is compared with Technical/Functional quality of services in private banks. Results showed that Technical/Functional quality model is better (Lassar et.al, 2000). A survey of 801 customers indicated that customers' perception of service quality differs in terms of demographic characteristics (gender, ethnicity, education and income) of the respondents (Urban and Pratt, 2000).

Oppewal and Vriens (2000) empirically investigated the relationship between service quality and customer satisfaction by using original SERVQUAL instrument with 10 dimensions as devised by Parasuraman et al. (1985). This study gave a direction to relate
service quality and customer satisfaction. Service quality gained significance with the passage of time due to increased competition among service firms. It was examined that how customer satisfaction affects the customers' behavioral consequences. The study found a strong impact of customer satisfaction on their decision to stay with the existing service provider; and restrain their negative behavioral intentions. (Athanassopoulos, Gounaris and Stathakopoulos, 2001).

Kayis, Kim and Shin (2003) conducted a comparative analysis of Australian and Korean banks to find out the quality management practices and its outcomes. They found a meaningful relationship between perceived service quality and customer satisfaction. They suggest that organizations should focus on service quality as an input to customer satisfaction for long-term benefits and business success. Now banks have realized the importance of service quality for successful survival in today's global and highly competitive environment (Wang et al. 2003).

Jamal (2004) investigated the customer behavior in retail banking by considering service quality its outcomes. It was observed that customers have varied experiences of satisfaction and dissatisfaction for utilization of self-service technologies. Financial sector is becoming more conscious about the performance evaluation regarding quality of products/services according to customers’ expectations. In another study, findings reveal a positive correlation between financial performance and customer service quality scores (Duncan and Elliott, 2004).
Curry and Penman (2004) reported that service quality is inevitable for differentiation to compete in the banking sector. They suggested that the right service could retain the customers for long-term benefits. So, Banks should maintain the level of services by proper allocation of resources to meet customer requirements. Findings indicated that financial institutions require reasonable procedures to evaluate the overall satisfaction of their customers. However, understanding of changing needs and expectations of customers is an essential prerequisite for the financial sector (Joseph et al. 2005).

Jabnoun and Khalifa (2005) proposed and tested a measure of service quality to compare conventional and Islamic banks in UAE. The study found that four dimensions were significant in case of conventional banks. While only personal skill and values were crucial in determining service quality in Islamic banks. It is found that bank-customer relationship quality is evident between satisfied and dissatisfied customers. Both types of customers have clearly distinctive feelings regarding their service experience (Nelson and Chan, 2005).

Al-Hawari and Ward (2006) found that customer satisfaction plays an inter-mediator role in the relationship between service quality and financial performance of the banks. In another study, overall customer satisfaction was investigated in Malaysian banking industry by collecting data from 220 customers of 15 retail banks. It was found that overall customer satisfaction is one of the key determinants of relationship quality (Nelson, 2006). It is suggested that bank should start service quality improvement programs to enhance customer satisfaction and customer loyalty (Razak et al., 2007).
3.5 Service Quality, Customer Satisfaction and Bank Performance

There are few studies available in the literature that investigated the relationship between service quality, customer satisfaction and bank performance. Banks are dominant players of financial market having multiple opportunities in the recent age. Islamic banking practices came with numerous benefits for individuals, organizations and society. It is suggested that service performance appraisal system of the organization should be improved in line with customer satisfaction in the banking sector (Kayis, Kim and Shin, 2003). Financial performance of banks and other financial institutions could be measured by using the conventional method of accounting as well as latest measures of risk and expected returns (Duncan and Elliott, 2004).

Swan and Combs (1976) stated that satisfaction could be linked with performance because people feel satisfied when products perform according to their expectations. But they experience dissatisfaction when performance is below than their expectations. It is found that service firms show poor performance due to lack of knowledge about customers' expectation (Zeithmal et al. 1993). There are few studies that investigated direct and positive relation between service quality and profitability (Zahorik and Rust, 1992; Heskett et al., 1994; Rust et al., 1995).

The expansion of the banking industry requires a study to assess the service quality offered by banks and customers' feelings regarding their experience and how it affects bank performance. It was documented that an increase in service quality and professional
behavior resulted greater customer satisfaction and reduced customer erosion (Leeds, 1992). Heskett et al. (1994) reported that there is an evident relationship between services and profitability. The study suggested that customer satisfaction affects customer loyalty that leads to greater profitability. It is concluded that customer satisfaction resulted into profitability, so banks must focus on each customer to maximize their profits (Hallwell, 1996).

Newman and Cowling (1996) examined service quality in retail banking by comparing two banks in UK. They found that service quality is essential for banks due to link between quality, productivity and profitability. They also found that service quality helps to reduce the costs. It is suggested that the performance of banks can be measured as how they develop and maintain relations with their customers. The success of banks depends upon customers' willingness to stay with them (Ennew, 1996). It is concluded that the success of banks could be evaluated by the implementation of service quality programs to retain customers as satisfied with services (Yavas, and Shemwell, 1997).

Ebrahim and Joo (2001) reported that Islamic banks have shown an excellent performance in Brunei Darussalam during last few years and captured 11.5% of total market share. Islamic banks could reap many benefits due to diversification and innovation of their products/services according to Principles of Sharia’h. It is reported that customer satisfaction with services in banking has declined over a number of years. The study recommended that an improvement in service quality is necessary for higher satisfaction level (Allred, 2001).
Starkey, Williams and Stone (2002) examined the customer management performance in Malaysia by comparing banking industry with other industries. Findings showed that customer management performance is very poor in retail banking and insurance industry as compared to other industries under the study. In another study, 1000 retail banking customers were analyzed in Malta and it is found that customer satisfaction played a mediating role between service quality and service loyalty (Caruana, 2002). Similarly, service quality has significant influence on bank reputation (Wang et al., 2003). It was found that there is significant relationship between service quality and financial performance (Duncan and Elliot, 2002).

Jabnoun and Al-Tamimi (2003) measured service quality in the UAE commercial banks by using a modified version of SERVQUAL. The study found three dimensions as reliable and valid namely empathy, human skills and tangibles. Similarly, findings of another study suggested that organizations should concentrate on service quality and customer satisfaction to gain competitive position in the market for long-term business success (Kayis, Kim and Shin, 2003).

Mukherjee, Nath and Pal (2003) examined efficiency of banking services by considering service quality, resources and the performance triad in India. Findings proved that there is a relationship between resources, service quality and performance of banks. Customers analyze different aspects of services to repeat their experiences in the future. It is found that superior delivery of services results into superior profitability (Kotler, 2003). It is reported that customer satisfaction partially mediates the relationship between effect of
justice and word of mouth in the banking sector (Maxham, 2003). Islamic banking practices in developing economies helped to minimize risk and inflation. The study concluded that profit and loss sharing option is very attractive for the bank. Equity based ventures help the bank to reduce risk and monitoring costs (Ghannadian and Goswami, 2004).

Gao, Jia and Zhao (2006) examined the service quality and its attributes to measure the performance of retail banks in China. They conducted statistical analysis of the national survey to identify existing obstacles and their solutions to improve service quality and customer satisfaction for six major local banks in China. They suggested that provision of better service quality than competitors could result into satisfied and loyal customers for greater benefits.

Gritti and Foss (2007) empirically investigated the relationship between customer satisfaction and loyalty and its impact on profitability in Italian banking sector. They found that customer satisfaction influences loyalty that results into direct effect on financial and non-financial customer value. It is reported that bank efficiency and shareholders' value is the outcome of customer satisfaction score. It is suggested that customer satisfaction scores require an adjustment for branch locations for customer service. It could increase the bank efficiency by reducing divergence in efficiency scores (Tripe, 2007). In another study, the service quality and bank performance examined in Jordan based on a sample of 346 respondents. Findings showed that dimensions of service quality have a positive impact on bank performance (Akroush, 2008).
3.6 Hypotheses, Conceptual Model and Theoretical Framework

The expansion of the banking industry requires a study to assess service quality in relation to customers' satisfaction and its influence on bank performance. Islamic banks are striving to capture the maximum number of customers to compete with conventional banks by providing a large number of products as an alternative for interest based products. In Pakistan, banks are providing a wide range of products and services and facing intensive competition to attract potential customers. It is reported that banking and financial services are the integral part of services industry and its contribution is increasing with the passage of time (Mishkin, 2001). However, expansion of global and integrated banking sector has to face many challenges of legislation, technological and structural changes (Angur et al. 1999).

Parasuraman et al. (1985, 1991b) devised SERVQUAL model and investigated the service quality. They explored ten dimensions of service quality and refined into five dimensions. It was documented that an increase in service quality and professional behavior resulted a greater customer satisfaction and reduced customer erosion (Leeds, 1992). The relationship between service quality and customer satisfaction is becoming crucial with the increased level of awareness among bank customers (Sureshchander et al. 2002). Demographic characteristics should be considered by the bank managers to understand their customers. Customers' perception of service quality differs in terms of gender, ethnicity, education and income (Urban and Pratt, 2000). This study assessed the customers’ perception of service quality on the basis of gender due to traditional and
cultural context in the prevailing socio-economic conditions of Pakistan. There are number of studies that investigated service quality perception of bank customers in the different parts of the world (Imam, 1987; Anakwue, 2002; Omar and Ogenyi, 2004).

Boyd et al. (1994) investigated the bank selection criteria on the basis of demographic characteristics and found a significant difference between service quality perception of white collar customers and low income customers. It is reported that gender roles and responsibilities are shaped due to specific cultural, social and religious factors. In Muslim countries male is responsible for financial activities outside the home while female performs domestic activities inside the home (Obbe, 1980; Kinsey, 1988; Ogenyi, 1997; Iheduru, 2002). Due to these factors men have more access to banking, education and insurance facilities as compared to women (Ajakaiye and Olomola, 2003).

Ayadi (1996) concluded that female bank customers are engaged in lesser banking activities than male customers due to lower income. It is reported that customers' perception of service quality is very important for managers to compete in the market (Hoffman and Bateson, 2002). Customers' perception of service quality is strongly dependent on customers' values and beliefs that vary from one culture to another (Furer et al., 2002). It is found that gender affects the service quality perception of bank customers and they show a varied response towards different dimensions of service quality (Spathis, 2004). Similarly, a varied pattern of customer satisfaction and behavioral outcomes is observed among male and female bank customers (Yavas, Babakus and Ashill, 2007). In another study, findings showed that there is difference in choice factors by male and
female bank customers in selection of their respective bank (Omar, 2008). Based on these studies, it can be hypothesized that there is significant difference in the perception of bank customers on the basis of gender.

H$_1$: There is a significant difference in the perception of service quality among bank customers on the basis of gender.

Levesque and McDougall (1996) reported that service quality has a significant impact on customer satisfaction and their intentions to switch. It is found that service quality is an important determinant of customer satisfaction by dealing with complaint behavior and commitment in Turkish banking industry (Yavas et al., 1997). However, an improvement in service quality is necessary for higher levels of satisfaction among banking customers (Allred, 2001).

Caruana (2002) suggested that banks should concentrate on service quality and customer satisfaction to gain competitive position in the market. Similarly, it is suggested that service performance appraisal system of an organization should be improved in line with customer satisfaction in the banking sector (Kayis, Kim and Shin, 2003). Iglesias and Guille’n (2004) explored direct and positive relationship between perceived quality and level of satisfaction. It was reported that in developing countries like India and Philippines results were systematically and significantly different from developed countries like U.S.A. (Malhotra et al., 2005).
Curry and Penman (2004) reported that service quality is important for differentiation to compete in the market and retain the customers as satisfied for long-term benefits. However, understanding of changing needs and expectations of customers is an essential prerequisite for the financial sector (Joseph et al. 2005). It is suggested that the meeting of customers' expectation is crucial to increase customers' satisfaction by delivery of better quality services (Gao, Jia and Zhao, 2006). It is found that there is a positive relationship between service quality and customers satisfaction (Razak, Chong and Lin, 2007). Above-mentioned literature provides a foundation to hypothesize that there will positive relationships between service quality and customer satisfaction in Pakistani banking sector.

H2: There is positive relationship between service quality and customer satisfaction in the banking sector of Pakistan.

Figure-3.4

Graphical display of the hypothesized relationship between service quality and customer satisfaction
Banks are dominant players of financial market having multiple opportunities in the recent age. It is found that services firms show poor performance due to lack of knowledge about customers' expectation (Zeithmal et al. 1993). There is an evident relationship between quality of services and profitability. Customer satisfaction affects customer loyalty that leads to greater profitability (Swan and Combs, 1976). Hallwell (1996) concluded that customer satisfaction resulted into profitability, so banks must focus on each customer to maximize their profits. The success of banks depends upon customers' willingness to stay with them (Ennew, 1996).

Newman and Cowling (1996) found that service quality is important for banks due to link between quality, productivity and profitability. Performance of banks could be measured as how they develop and maintain relations with their customers. Progress of banks can be evaluated by the implementation of service quality programs to retain customers as satisfied (Yavas et al., 1997). It can be hypothesized that there will be positive relationship between service quality and bank performance.

\[ H_3: \text{There is positive relationship between service quality and bank performance in Pakistan.} \]

Figure-3.5

Graphical display of the hypothesized relationship between service quality and bank performance
Customer satisfaction is an important driver for better organizational performance especially in the banking sector due to increased competition. Several studies measured the relationship between customer satisfaction and performance of the firm (Anderson et al., 1994; Wiele et al., 2002; Yeung et al., 2002; Al-Hawari and Warid, 2006). However, there is a severe shortage of literature that specifically measured the performance of banks with reference to service quality and customer satisfaction. Ebrahim and Joo (2001) reported that Islamic banks have shown an excellent performance. They suggest that Islamic banks should diversify their products/services according to principles of Sharia’h. There is a significant relationship between service quality and financial performance (Duncan and Elliot, 2002). So it is concluded that superior delivery of services results into superior profitability (Kotler, 2003). Mukherjee, Nath and Pal (2003) found relationship between resources, service quality and performance of banks. It is recommended that profit and loss sharing option is very attractive for the bank. It helps the bank to reduce risk and monitoring costs (Ghannadian and Goswami, 2004). On the basis of literature it is hypothesized that there will be positive relationship between customer satisfaction and bank performance in Pakistan.

H4: There is positive relationship between Customer satisfaction and bank performance in Pakistan.

Figure-3.6

Graphical presentation of the hypothesized relationship between customer satisfaction and bank performance
Gao, Jia and Zhao (2006) suggested that provision of better service quality than competitors could result in satisfied and loyal customers for greater benefits. While it is found that customer satisfaction plays an inter-mediator role in the relationship between service quality and financial performance of the banks in Australia (Al-Hawari and Ward, 2006). It is documented that customer satisfaction results into financial and non-financial customer value (Gritti and Foss, 2007). It is suggested that customer satisfaction could increase the bank efficiency by reducing divergence in efficiency scores (Tripe, 2007). It is reported that quality implementation initiatives mediate the relationship between service quality and bank performance (Akroush, 2008). On the basis of literature, it is assumed that customer satisfaction will mediate the relationship between service quality and bank performance.

H₅: Customer satisfaction mediates the relationship between service quality and bank performance in the banking sector of Pakistan.

Figure-3.7
Graphical presentation of the hypothesized mediating role of customer satisfaction between service quality and bank performance.

![Diagram showing mediation role of customer satisfaction]
Figure- 3.8

*Service Quality, Customer Satisfaction and Bank Performance in Pakistan*

Comparative Study of Islamic Banking 92

Conceptual Model and Theoretical Framework
Summary of Hypotheses

H1: There is a significant difference in the perception of service quality among bank customers on the basis of gender

H2: There is positive relationship between service quality and customer satisfaction in the banking sector of Pakistan

H3: There is positive relationship between service quality and bank performance in Pakistan

H4: There is positive relationship between customer satisfaction and bank performance in Pakistan

H5: Customer satisfaction mediates the relationship between service quality and bank performance in the banking sector of Pakistan.