



## The Competitiveness Creation Strategy of Islamic Banking

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### ABSTRACT

**Objective** – The development of Islamic banks in Indonesia requires a new strategy. The size of the population of Indonesia is a potential market for Islamic banks to target religious and non-religious customers and implement quality innovation to create value-based services to support the competitiveness of regional economies. This may improve the standard and quality of living. Specifically, this study investigated the influence of Islamic banking service quality dimensions to consumer satisfaction, word-of-mouth communication and loyalty.

**Methodology/Technique** – This study was conducted in Banjarmasin, South Kalimantan, which is an Indonesian province that has a fairly a rapid rate of development of Islamic banking. The study focused on 191 people. Data collection was done by observation and interviews using questionnaires.

**Findings** – Using Partial Least Squares, the results demonstrates the effects of variable compliance, empathy, and value proposition quality on overall satisfaction. This showed that overall satisfaction influences word-of-mouth communication and loyalty. This indicates that both the religious market consumers and the floating market consumers desire the establishment of a strong emotional bond between the Islamic bank, customers and shareholders that are developed together in the face of business risks and share profits fairly and honestly, in accordance with the principles of Islamic law. Furthermore, they want employees to be more empathetic and respond individually to customers.

**Novelty** – The study suggest that a strategy be created in relation to competitiveness in Islamic banking in Banjarmasin to improve the quality of service-based value, and to increase the cultivation of religious customers as well as penetrating the floating market segment.

**Type of Paper:** Empirical.

**Keywords:** Carter-Item; Floating-Based Market; Islamic Bank; Religious-Based Market; Servqual.

**JEL Classification:** G21, M21, M31.

### 1. Introduction

Islamic banking in Indonesia is experiencing a rapid growth and great potential in serving all segments of society. It has the potential to become an alternative to support the country's economy. The role of Islamic banking in the national banking system is not much different from conventional banking in Indonesia. One fundamental difference between the two is the principles in financial transactions/operations as Islamic banking applies profit and loss sharing between the bank and customers. This principle does not apply to conventional banks which apply the system of interest (Sasmitasiwi, Banoon, and Cahyadin, 2007).

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Islamic banks are not associated with religious rituals, but rather the concept of revenue sharing between the customers and the bank. Although Islamic banks in Indonesia were developed by the Islamic society, bank management with Islamic principles can be accessed and maintained by all interested communities; it is not limited to Muslim communities. Viewed from this aspect, the development opportunities of Islamic banks in Indonesia is substantial owing to the fact that Indonesia has the largest Muslim population in the world.

The development of Islamic banks in Indonesia requires a new strategy. In addition to attracting customers for religious reasons, Islamic banks also offer their products to the floating market i.e. consumers who choose Islamic banks not based on religious grounds. The Indonesian Islamic banking industry has grown on average by 30 to 40% over the last five years (Djaelani, 2014). Based on a survey conducted between 2000 and 2005, the market potential of Islamic banking in Indonesia is quite in line with the rapid development of banking/international Islamic finance (Bank Indonesia 2008). Although there is potential to develop several Islamic banking opportunities, there are also challenges faced with regard to bank management factors such as product innovation, quality of human resources and the need to understand the Islamic financial community (Djaelani, 2014). The market potential of Islamic banking requires Islamic banks to seek the development of innovative models of service quality, based on the quality and value proposition of delivering value to achieve customer satisfaction and loyalty towards the competitiveness of the Islamic banking industry.

The prospects of Islamic banking in the province of South Kalimantan, Indonesia, are high as the majority of the population there is Muslim. The total number of Islamic banking institutions in South Kalimantan consists of six Islamic Banks, 24 Credit Bank (BPR), and one BPR sharia, with a network of 196 offices and 123 ATMs ([https://id.wikipedia.org/wiki/Kalimantan\\_Selatan](https://id.wikipedia.org/wiki/Kalimantan_Selatan), accessed 2016). The large Islamic population represents a potential market for Islamic banks to target both religious and non-religious customers and implement quality innovation to create value-based services to support the competitiveness of regional economies. This may improve the standard and quality of living. One of the areas in South Kalimantan province with potential for development of Islamic banks is the city of Banjarmasin, which is supported by a large population of 675.440 Muslims in 2015 (BPS Kota Banjarmasin, 2015).

## 2. Literature Review

To date, Islamic banks are generally still targeting loyalists of sharia or the Islamic law market (Yusdani, 2006). Rarely do Islamic banks try to capture the general market (floating market) however Islamic banks may benefit to marketing to non-Muslim customers. Penetration of this market segment is expected to be easy given that Hindu, Buddhist, Jewish and Christian teachings also believe that they should not charge interest to poor believers for a personal hardship loan. However, there is no specific law that prohibits interest on visiting traders for business, as long as the interest rate is not excessive and the parties do not take advantage of each other.

According to Estiri et al. (2011), the quality of value proposition and value delivery have significant and positive impacts on satisfaction. Their study focused on service delivery components and value proposition quality which was adopted as factors affecting customer satisfaction on service companies such as Islamic banks and credit institutions (Estiri, et al., 2011). There are three dimensions of value proposition quality. First, components that are inherent in the service, the characteristics of the bank's portfolio of products such as the amount of savings, current account and the amount of investment. Second, the value of communication and training, providing the accuracy and real-time information that is made up of components such as features and price. Third, the convenience that consists of the brand and their reputation. The quality of value delivery is originally derived from the SERVQUAL measurement, proposed by Parasuraman et al (1988), with 5 dimensions i.e. empathy, tangibility, responsiveness, reliability and assurance.

Islamic banking would benefit from placing cultural differences at the center of their attention when adjusting their service quality (Othman & Owen, 2001). Othman and Owen (2001) suggest a new model for measuring the dimensions of service quality by adding a dimension of "compliance with Islamic law" to the SERVQUAL model; the modified model is called the CARTER-item system. A study conducted by Shafie, et

al. (2004) showed that the application of the CARTER-item system in dealing with consumer perceptions of Islamic banks in Malaysia had a significant effect on customer satisfaction.

Product or product attributes are the main stimulus that influences affection, cognition, and consumer behaviour. Consumers meet the demand for goods and services by making purchases. During the purchase process, a buyer sets up an expectation value. In the marketing literature, value directly influences the selection criteria of consumers and indirectly influences their attitudes, interests and buying behaviour (Pitts & Woodside, 1984 in Tsiotsou 2005).

A study conducted by Tsoukatos and Graham (2006) showed that SERVQUAL's dimensionality is not confirmed in the Greek insurance industry. While a non-tangibles and tangibles structure exists in Greek insurance, "tangibles" do not affect customer satisfaction while word-of-mouth ('WOM') is an antecedent of repurchasing intentions. The findings from Estiri et al (2011) reveal that service quality in Iranian banking adopting the commercial format of Islamic services has a two-factor structure: value proposition quality and service delivery quality. The dimensions of value proposition include the perception of respondents in the product portfolio of the bank, the banks communication with its customers, the accuracy of the information given to the customer, the price of products and services offered by the bank, and the bank's reputation and brand.

Customer satisfaction is a function of perceived performance of products and expectations of buyers. Customer satisfaction has a positive influence on loyalty (Lee, 2010 in Chinomona & Sandada, 2013). In addition, research conducted by Lin & Wangs (2006) and Avramakis (2011) in Chinomona & Sandada (2013) shows that customer satisfaction positively affects customer loyalty.

Based on these theories and previous research, the following hypotheses are put forward; Hypothesis 1 (H1): The service delivery quality (Carter-item system which consist of compliance, assurance, reliability, tangibility, empathy and responsiveness) positively affects overall satisfaction. Hypothesis 2 (H2): The value proposition quality positively affects overall satisfaction. Hypothesis 3 (H3): Overall satisfaction positively affects WOM. Hypothesis 4 (H4): Overall satisfaction positively affects customer loyalty. Hypothesis 5 (H5): WOM positively affects customer loyalty.

### 3. Research Method

This research was conducted in the city of Banjarmasin. The sampling technique used a purposive sampling technique with the following criteria; first, the study area was based on the actual condition and potentials regarding the number of boarding schools, places of worship, population by employment, trade and banking. Secondly, there is a Sharia and Islamic Bank. Third, the sampling of respondents includes religious based and floating based market consumers. There were 191 respondents that were considered sufficiently representative for this study. Hypotheses were tested based on structural equation modeling using the Partial Least Squares ('PLS') method.

### 4. Results

Out of a total of 191 respondents, there were 96 women (50.3%) and 95 men (49.7%). The age was varied; 46.6% were aged between 18 to 29 years, 20.42% were aged 30 to 39 years and 32.98% were aged 40 years and over. The professions of respondents were 1% farmers, 14.1% civil servants, 31.4% self-employed, 4.7% employees of state-owned enterprises, 24.1% employees of private enterprises, with the remaining 24.6% being employed in professions other than those professions above.

The tools used in the SmartPLS 2.0 program were designed specifically to estimate variance-based structural equations. There are three criteria in the use of data analysis techniques used to assess the outer SmartPLS models; convergent validity, discriminant validity, and composite reliability.

In Figure 1, for the convergent validity of measurements models, all factor loadings exceeded the recommended value of 0.50 (Gozali 2008). As shown in Table 1, all constructs reliably meet the criteria. This

is indicated by the composite value reliability above 0.70 and AVE above 0.50 as recommended by the criteria (Ghozali, 2008).

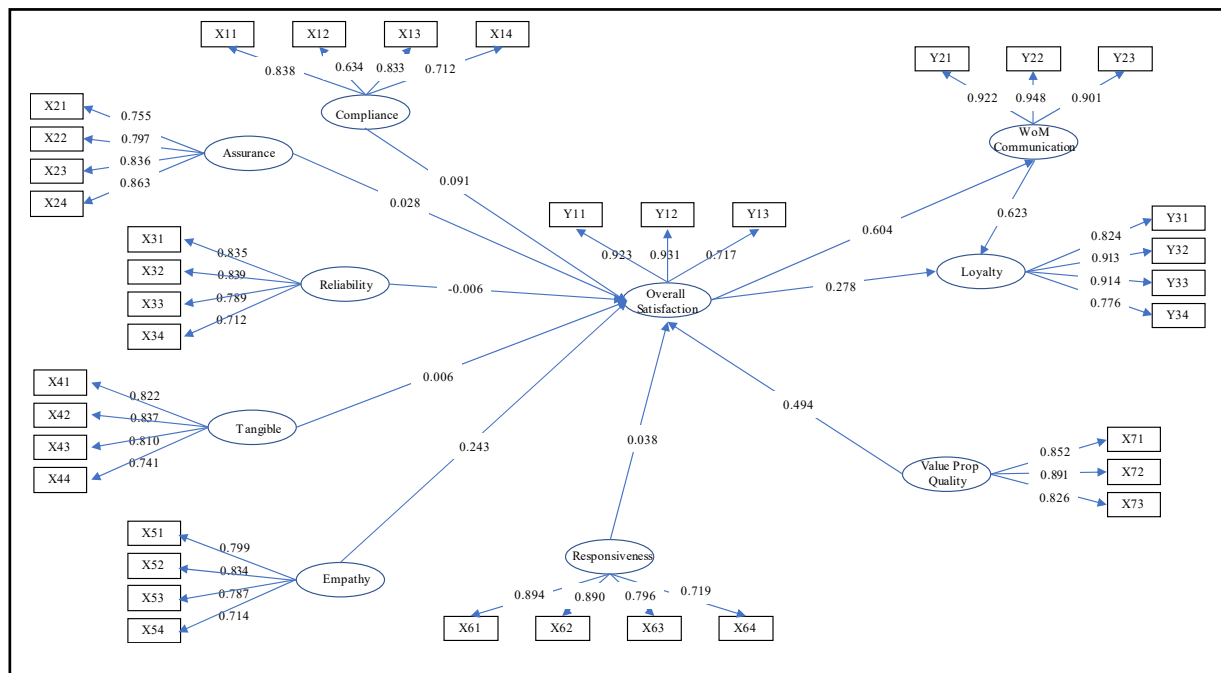


Figure 1. Structural Equation Modelling

Table 1. Composite reliability and average variance extracted

Construct	Average Variance Extracted (AVE)	Composite Reliability (CR)
Compliance	0.576	0.843
Assurance	0.662	0.887
Reliability	0.633	0.873
Tangible	0.645	0.879
Empathy	0.608	0.861
Responsiveness	0.685	0.875
Value Proposition Quality	0.734	0.892
Overall Satisfaction	0.745	0.846
WOM	0.853	0.946
Loyalty	0.737	0.918

In PLS, the significant value of the “results for inner weight” will provide information about the relationship between the variables of the study. The test results of the direct relationship between variables can be seen in Table 3. The results support four hypotheses of the study; H2, H3, H4 and H5. In relation to H1, only compliance and empathy significantly affected overall customer satisfaction.



Table 3: Result for Inner Weights

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T statistic (IO/STER RI)	P value
Compliance→ Overall Satisfaction	0.091	0.097	0.051	1.787*	0.076
Assurance →Overall Satisfaction	0.028	0.023	0.079	0.353	0.725
Reliability→Overall Satisfaction	-0.006	-0.003	0.086	0.075	0.940
Tangible→Overall Satisfaction	0.006	0.014	0.076	0.073	0.942
Empathy→ Overall Satisfaction	0.243	0.253	0.078	3.096	0.002
Responsiveness→Overall Satisfaction	0.038	0.037	0.065	0.580	0.563
Value Prop. Quality→Overall Satisfaction	0.494	0.463	0.083	5.932	0.000
Overall Satisfaction→WOM	0.604	0.608	0.042	14.309	0.000
Overall Satisfaction→Loyalty	0.278	0.277	0.053	5.214	0.000
WOM Communication→Loyalty	0.623	0.628	0.049	12.754	0.000

\* $\alpha=10\%$ 

## 5. Discussion and Conclusion

Both religious-based and floating-based market customers positively perceived Islamic banking. In the Carter-item test, the results showed that only compliance and empathy affected overall satisfaction while value proposition quality strongly affects overall satisfaction.

Islamic banks are operated on the basis of the principles and laws of Islam. 'Compliance' refers to the ability to fulfil the law of Islam and operate under the principles of Islamic economics (Shafie et al., 2004). In connection with the compliance variable, this study used four indicators covering; (1) Islamic banks apply the principles of Islamic law, (2) Islamic banks do not pay interest on savings, (3) the bank provides banking products in accordance with Islamic law and (4) the bank engages in profit sharing in investment products. 90.1% of respondents agreed with the principles of Sharia Islamic law whereas 8.4% of respondents did not show interest in the principles of Islamic law, while only 1.5% of the respondents stated that the banks do not need to apply principles of Islamic law.

That the value proposition quality has a significant influence on overall satisfaction indicates both religious-based and floating-based market customers look for a strong emotional bond between the bank and customers, and value when profits are shared fairly and honestly in accordance with the principles of Islamic law. Furthermore, they look for bank employees to be more empathetic to customers. Thus, creation strategy competitiveness of Islamic banking is likely to improve the quality of service-based value and increase the cultivation of the loyal religious-based market as well as penetrating the floating market segment. Islamic banks should also provide ample opportunity to the customers to be successful, especially in relation to small and medium entrepreneurs, through providing financing facilities and equipment procurement of capital goods production through a feasibility business analysis rather than a guarantee, so as to improve the welfare of the community.

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