

# A Study on the Role of Service Quality on Customer Retention in Banks

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## Abstract

*Service quality has become an important tool in the service industry. The concept of customer satisfaction is widely recognized as a key differentiator which occupies a central position in marketing thought and practice and is the major outcome of any marketing activity. There is a plethora of research on service quality in relation to the many domains of service marketing specially in managing customers' behaviour. Customer service is the touchstone for success in the service industry. The banking industry has been chosen in the retail financial sector for this research study because as a service, its attributes are essentially. This is a quantitative research paper which examines the importance of service quality on customer retention. This study has adopted non probability sampling method and the customers of the selected banks constitute the sample frame. The data has been analysed using SPSS version 16. Multiple regression analysis has been used to analyse the data.*

**Key Words:** Service Quality, Customer Satisfaction, Customer Retention, Banks.

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## 1. INTRODUCTION

Customers' needs are always evolving, an aftermath of shrinking world borders and a free access to competitive brands of products or services that are often comparable to global standards. There are multiple factors impacting the service industries like globalization, competition and volatile market dynamics. The most important attribute that separates competitors is the quality of service delivered to the customers by trying to bridge the gap between the customers' expectations and experience.

In the service industry, despite the increased awareness of the importance of customer service to the business, the question "*What drives performance?*" is at the top of the minds of all the stakeholders of any service industry. The first step in delivering quality service to the customers is that the service providers need to be very adaptive to the customer needs [1]. The typical banking attributes such as employee courteousness, employee behaviour in general, speed of service, convenience of location and so on are almost synonymous with the consequences of developing a long term relationship with the customer. The sequences of employee service behaviour on customer service quality satisfaction can be viewed as signals of retention or defection and are appropriate for monitoring. Also, as per the American Customer Satisfaction Index (ASCI) report, banking industry is one service category that has continued to decline in customer retention [2]. The most popular view of customer satisfaction in academia is that customer satisfaction is the judgment borne out of the comparison of pre-purchase expectations with post purchase evaluation of the product or service-experience that is dominated by two theoretical perspectives; customer service and SERVQUAL methods.

## 2. REVIEW OF LITERATURE

The available literature indicates that the actual delivery of service by both public & private sector banks in India falls short of the expectations of customers on a large majority of the elements of service quality despite the fact that the private sector banks are found having an edge over public sector banks in terms of quality of services being offered to customers [3].

The most widely used method of measuring service quality is the SERVQUAL instrument [4]. It is a 22 item or statement instrument developed on the basis of the differences between the perceptions and expectations of customers regarding the dimensions of service quality. Alternatively Cronin and Taylor (1992) [5] developed SERVPERF which is a modified version of SERVQUAL with the same five service quality dimensions is generally used to evaluate service satisfaction.

The services and marketing literature has asserted that the service quality is primarily formed by frontline employees' service behaviour and the respective consequences during service encounters which typically involves personal interactions between the employee and the customer [6] including customer perceptions of service quality.

## 3. CUSTOMER SERVICE QUALITY

The success of any organization is measured in its ability to quickly respond to market changes with more efficient satisfaction and customer retention.

According to Allred and Addams (2000), service quality is a significant issue in the service industry, and more importantly, for financial service providers, who have difficulty demonstrating to their customers the differentiation by products alone [7]. Service quality is the result of human interaction between the service provider and the customer. Marketers of services realize that to successfully leverage service quality as a competitive edge, they first need to correctly identify the antecedents of what the consumer perceives as “service quality”. From this perspective, the model proposed by Parasuraman, Zeithaml and Berry provides wide citations of the applied dimensions of service quality [8]. Evaluation of service quality becomes difficult due to three characteristics that are inherent in services – intangibility, heterogeneity and inseparability [9]. However, research has suggested there is a strong correlation between the ability of customer service providers to develop strong customer relationships with consumers which attribute to outcomes such as customer satisfaction, customer service quality and loyalty [10].

Service quality and customer satisfaction have been investigated by many researchers and results have shown that the two constructs are definitely independent [11]. In 1988 Parasuraman, Zeithaml and Berry developed a generic instrument called SERVQUAL to measure service quality based on input from focus groups. It is based on the proposition that service quality can be measured as the gap between the service that the customers expect and the service they perceive to have received and is calculated as the difference in the two scores where better service quality results in a smaller gap. Although the instrument was developed within the marketing sector, it is also being used in a variety of organizational settings [12]. Since 1988 they have made numerous changes to SERVQUAL in response to the problems identified by other researchers [13] and have recommended three different SERVQUAL formats which the researchers can use to separate customer expectation scores into tolerance zones. From a customer’s perspective, quality is perceived as being two-dimensional, composed of technical and functional qualities (Caruana, 2002) [14].

Gronroos (2007) further modified his model and underlined the function of output quality and process quality as happening prior to and resulting in consequence quality [15]. He referred the technical quality to the solution conveyed to the customer by a specialist. Functional quality was concerned with the

outcome of the development delivered to the customer. This was further supported by Cronin and Taylor who focused on the functional quality of SERVQUAL to evaluate the customers’ perceptions of the service provider’s performance and called this instrument SERVPERF [16], a subset of ‘SERVQUAL’, which utilizes the same five dimensions of the SERVQUAL as the five performance dimensions. When Cronin and Taylor compared SERVPERF to SERVQUAL, their results supported that performance scores alone account for more variation in service quality than performance minus expectations [17]. Likewise, other studies suggested that SERVQUAL has unstable dimensions. For instance, Jiang, Klein and Carr used four dimensions in their study [18], while Landrum and Prybutok used five dimensions [19].

SERVPERF uses the SERVQUAL dimensions which measures only customers’ perceptions of service provider performance. While additional dimensions such as individual impact, work group impact and organizational impact have been identified as influencing system for organizational success [20, 21, 22]. On the basis of these findings, this research study has used the functional quality of the SERVQUAL instrument to analyse the performance of the bank employees assessed on the basis of the emotional intelligence levels. However there exists limited published information about the relative importance of each dimension in the banking industry particularly in the Asian countries.

#### **4. CUSTOMER SATISFACTION AND CUSTOMER RETENTION**

Customer satisfaction is a function of expectations and disconfirmation and one of the key elements of business success and profitability is customer satisfaction, the more satisfied the customer, the more durable the relationship. The 1980’s saw the emergence of customer service literature in the form of qualitative service research that identified and illustrated customer satisfaction and service quality. Studies of customer behaviour placed emphasis on customer satisfaction as the fundamental of the post purchase stage. Customer satisfaction acts a catalyst to customer retention [23] (and in turn this relationship leads to enhanced market share [24,25] The past literature examines the link between customer service performance and customer satisfaction through many factors such as information technology [26] customer orientation [27] [28].

Hallowell used 12,000 retail-banking customers at 59 divisions to examine the hypothesized relationships between customer satisfaction, customer loyalty and profitability supported the hypothesis that customer satisfaction is related to customer loyalty, leading to the positive relationship with profitability but the measure of customer retention was not defined and hence Hallowell suggested further studies on this topic in industries other than banking. Further Moira (1997) [29] indicated that customer retention rates in many service businesses is particularly difficult to measure because many companies do not understand the significance of improving customer retention rates and the impact that this can have on profitability. The customer service posits a positive relationship between staff satisfaction, service quality and customer satisfaction leading to profitability while SERVQUAL distinguishes between functional service quality and technical service quality and recognises the significance of staff satisfaction and their service performance as drivers of customer satisfaction.

Duncan and Elliot (2002) [30] established a link between superior customer service performance, customer retention and profitability which has become a prerequisite in the marketing literature. Furthermore, Gittel (2002) [31] found that a more effective relationship with customers created by service providers could lead to an increase in customer satisfaction and increased retention rates. In addition to these studies, prior research shows that customer satisfaction is a significant determinant of the customer retention (Ganesh, et al., 2000) [32].

The literature points out that the expectations are a key factor behind retention and it is seen that there exists strong linkages between service quality dimensions and customer retention [33]. Furthermore, the theoretical position regarding the management of customer retention appeared from three major viewpoints encompassing service marketing, industrial marketing, and general management. From the service marketing point of view, firms must improve customer service quality and satisfaction in order to retain customers (Ahmad & Buttle, 2002) [34] indicating that there is a strong link between customer satisfaction and customer retention. The service quality school view satisfaction as an antecedent of service quality while the satisfaction school holds the opposite view that assessments of service quality lead to an overall attitude towards the service that they call satisfaction. Their primary use is two-fold: first, the customer experience with the company's goods and services and next the relationship between customer satisfaction and retention [35]. Customer's perception of Service and Quality of product will determine the success of the product or service in the market.

To illustrate that customer service quality positively influenced customer satisfaction, Parasuraman et al.(1985) proposed tangibles, reliability, responsiveness, communication, credibility, security, competence, courtesy, understanding and access were the following dimensions used to evaluate quality of service. They later condensed these primary dimensions to five dimensions which followed a generally accepted psychometric process in instrument design which led to the formation of the original "22-item *SERVQUAL*" tool. This instrument provides researchers with the ability to test the performance-expectation gap known as GAP 5, which is one of the gaps in the model of service quality. "The gap model positions the key concepts, strategies and decisions in delivering quality service in a manner that begins with the customer and builds the organization's tasks around what is needed to close the gap between customer expectation and perceptions" (Parasuraman et al., 1991) [36].

**Gap 1** is the discrepancy between customers' expectations and managers' perceptions of those expectations. **Gap 2** is the discrepancy between managers' perceptions of customers' expectations and service quality specifications. **Gap 3** is the discrepancy between service quality specifications and the service delivered. **Gap 4** is the discrepancy between the service provided and the service promised. **Gap 5** is the discrepancy between customers' expectations and their perceptions of service received. The *SERVQUAL* (Parasuraman et al., 1988) consisted of **Reliability** which is the capability to execute the promised service consistently and correctly. **Responsiveness** is an ability to assist customers and provide quick service. **Empathy** is a concern and personal awareness that a service provider gives to customers. **Assurance** is the knowledge and politeness of service providers and their ability to motivate trust and confidence. **Tangibles** are physical facilities, equipment, and the individual appearance of service providers. The last two dimensions (assurance and empathy) included communication, credibility, security, competence, courtesy, understanding customers and access dimensions. They condensed aspects of all ten dimensions originally conceptualized dimensions into five dimensions [37].

## 5. RESEARCH METHODOLOGY

This is a descriptive research study focusing on the quantitative analysis. The survey method was being used and a cross section of the population was selected. Questionnaires were used to collect data within the specified population. The bank customers constitute the population for this study. The sample frame refers to the customers of the banks in Bangalore's CBD. The sample size was determined by the sample size calculator formula sourced through internet. Secondary data has been made use of for review of literature and to identify

the research gap. The sample size of the customers is 500. SPSS 16 has been used to analyse the data. Multiple regression analysis has been used to analyse the The purpose of the study was to determine the degree to which service quality has its implications on customer retention in the banks of CBD (Commercial Business District) of Bangalore.

### 5. 1 Research Objective

To determine the variables of customer service quality which have an implication on customer satisfaction and likewise customer retention and is addressed by the following hypotheses.

### 6. DATA ANALYSIS

	Sum of Squares	df	Mean Square	F	Sig.
Regression	62.535	5	12.507	72.622	.000 <sup>a</sup>
Residual	81.632	474	.172		
Total	144.167	479			

relationship between service quality and customer satisfaction and likewise customer retention.

### 5.2 Hypotheses

**H<sub>01</sub>:** High degree of customer service quality does not ensure customer satisfaction as perceived by the customers.

**H<sub>02</sub>:** High degree of customer service quality does not ensure customer retention.

In this research study customer satisfaction and customer retention are considered dependent variables as against the service quality which is an independent variable.

**R=0.659, R<sup>2</sup> = 0.434, Adjusted R<sup>2</sup> = 0.428, SEE = 0.41499**

The mean score of customers' experience is 3.46 thereby contributing an average score of 3.416 to the customer satisfaction as a whole. R = 0.659 is the correlation coefficient which indicates that there is correlation between service quality and the customer satisfaction. R<sup>2</sup> = 0.434 is the coefficient of determination which indicates the degree of variability in the service quality variables. P value = 0.000 indicating that the significance value is < 0.05 ; indicates that the null hypothesis has to be rejected with an implication that high degree of customer service quality ensures customer satisfaction as perceived by the customers.

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<b>(Constant)</b>	<b>1.376</b>	<b>.238</b>		<b>5.780</b>	<b>.000</b>
<b>TANGIBLES</b>	<b>.316</b>	<b>.051</b>	<b>.402</b>	<b>6.175</b>	<b>.000</b>
<b>RELIABILITY</b>	<b>.212</b>	<b>.049</b>	<b>.240</b>	<b>4.310</b>	<b>.000</b>
<b>RESPONSIVENESS</b>	.001	.063	.001	.011	.991
<b>ASSURANCE</b>	-.002	.078	-.001	-.028	.977
<b>EMPATHY</b>	<b>.090</b>	<b>.040</b>	<b>.093</b>	<b>2.238</b>	<b>.026</b>

Dependent Variable : Customer Satisfaction

The regression analysis of service quality and customer satisfaction can be interpreted in terms of the regression equation;  $Y = a + b_1x_1 + b_2x_2 + b_3x_3$  and hence can be concluded that that customer satisfaction is dependent on the following SERVQUAL factors *tangibles, reliability and empathy*.

**H<sub>02</sub>:** High degree of customer service quality does not ensure customer retention as perceived.

	Sum of Squares	df	Mean Square	F	Sig.
<b>Regression</b>	16.830	16.830	3.366	21.937	.000 <sup>a</sup>
<b>Residual</b>	72.732	474	.153		
	89.562	479			

**R=0.433, R<sup>2</sup> = 0.188, Adjusted R<sup>2</sup> = 0.179, SEE= 0.39172**

R = 0.433 is the correlation coefficient which indicates that there is correlation between service quality and the customer retention.  $R^2 = 0.188$  is the coefficient of determination which indicates the degree of variability in the service quality variables. P value = 0.000 implying

that the significance value is  $< 0.05$ ; indicates that the null hypothesis has to be rejected with an implication that high degree of customer service quality ensures customer retention.

**Table 2b. Regression Analysis of Service Quality and Customer Retention**

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<b>(Constant)</b>	<b>3.126</b>	<b>.225</b>		<b>13.914</b>	<b>.000</b>
<b>TANGIBLES</b>	<b>.137</b>	<b>.048</b>	<b>.220</b>	<b>2.826</b>	<b>.005</b>
<b>RELIABILITY</b>	<b>.103</b>	<b>.046</b>	<b>.148</b>	<b>2.219</b>	<b>.027</b>
RESPONSIVENESS	.091	.059	.097	1.528	.127
ASSURANCE	-.031	.074	-.023	-.413	.680
EMPATHY	.034	.038	.044	.884	.377

Dependent Variable: Customer Retention

The result of the regression analysis of service quality and customer retention can be concluded that customer retention is dependent on the following factors of SERVQUAL *tangibles and reliability*.

## 7. RESEARCH FINDINGS

This study has considered the banking industry as its sample frame and analysed the relevant concepts in the context of the banking customers and the employees. The specific aim of this study was to analyse the customer perceptions of the delivery of service by the bank employees and their customer retention abilities thereof. This research study is guided by the analytical framework which investigates the relationship between service quality and customer retention. The statistical analysis supports the relevancy of the research problem and regression analysis was carried out to test the hypotheses in order to assess the relationship between service quality customer satisfaction and customer retention. The results of the data analysis pertaining to that of the bank customers' perception of service quality indicated that a better understanding of the service quality attributes is needed by the bank employees' to enhance their customer retention abilities. The significant influence of factors empathy specially on customer satisfaction coupled with tangibles and reliability on customer retention confirmed that bank employees need to be more competent in performing their job and more open and expressive about their thoughts and feelings which have a major impact on establishing relationships which is an antecedent to customer retention.

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## 8. CONCLUSION

As service encounters are a major determinant of customer service quality perception, it can be concluded that EI is an important factor influencing service quality. Furthermore, the significant relationships identified between EI, relationship marketing and service performance supports the proposition of incorporating EI in to the bank employee-customer service encounter. By considering relationship marketing construct as the mediator between EI and service performance, the constructs no doubt acted as significant mediator but mediated the relationship between the bank employees' EI and their service performance partially. Finally it can be concluded that this research study provides strong evidence that emotional intelligence predicts service performance which is an antecedent of customer retention. It has also provided insights into and has recommended that emotional intelligence tests with focus on relationship building should be incorporated in the banks' existing employees as well at the time of recruitment and selection process. The implications of this study are that the results can have a specific significance to bank marketing and are applicable to all the employees of the bank who have a customer interface. The role of the mediating variables CO and ADAPT interpreted in terms of employees EI has an active role in the performance of service by the employees which in turn impacts the quality of service delivered thereby leading to customer loyalty and retention.

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