

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Background**

The Islamic world is growing all over the world. According to the Pew Research Center's Forum on Religion and Public Life, the Muslim population of the world will grow to about 35% in the next 20 years, up from 1.6 billion in 2010 to 2.2 billion in 2030. Indonesia is a country located on the continent of Southeast Asia. Though much of the country of origin of the religion of Islam, but residents who embraced Islam in Indonesia is very large, i.e. around 12.7 percent of the total Muslim in the world. In 2010, the adherents of Islam in Indonesia around 216 million, or 88.1 percent of the total population. According to the BPS publications in August 2010, the total population of Indonesia based on the results of the census are as much as 237.556.363, consisting of 119.507.580 men and 118.048.783 women, with an average growth rate of 1.4% per year (Muhtar, 2013). This great market potentials should be utilized as soon as possible because people tend to prefer the appropriate product or service the one that clearly will be a Halal certificate for a product or service. The last few years, in addition to Islamic finance institutions, such as Islamic banking, Islamic insurance, Islamic pawn, and so on, the industry of Sharia in the country also "jazzed up" with the existence of Islamic business institutions. Sharia label business continued to surge, such as

hotels, hospitals, clinics, restaurants Sharia, or Muslim salon, MLM business online Islamic investment, and many more.

One of the businesses that doing Islamic rules is Islamic banking (Sharia banking). Why? Because the banking system implementation based on Islamic law (Sharia). Islamic banking has become a substantial and fastest growing industry during the last four decades. It has spread across the whole universe and received wide acceptance by both Muslims and non-Muslims (Iqbal & Molyneux, 2005). The establishment of this system is based on the existence of a prohibition in Islam to lend or picking up a loan with wearing loan interest (Riba), as well as the prohibition to invest in businesses prohibited (Harm) categories. The conventional banking system cannot guarantee the absence of such matters in its investments.

According to Khir, Gupta and Shanmugam (2008), Islamic banking was an abstract concept until the first half of the twentieth century. However, it has now become a full-fledged system and discipline. Islamic banking first gained its appearance in Egypt at Mit Ghamr by Ahmad El Najjar in 1963. In the seventies, many political changes have taken place in the Muslim countries which helps to facilitate the establishment of Islamic financial institutions. During this time, some Islamic banks came into existence in the Middle East. Examples are The Islamic Development Bank (IDB), the Dubai Islamic Bank (1975), the Faisal Islamic Bank of Sudan (1977), the Faisal Islamic Bank of Egypt (1977), the Bahrain Islamic Bank (1979), and the Philippine Amanah Bank (PAB) was set up in 1973, operates two windows for deposit

transactions in commercial and Islamic. Later, Islamic banks and financial houses were established in Qatar, Sudan, Bahrain, Indonesia, Guinea, Denmark, Turkey, England, Jordan and Switzerland. Now, it is estimated that there are more than 250 Islamic banks operating in over 75 countries. Even in non-Muslim majority nations like the UK, Australia, United States of America, they are attempting to set up Islamic Financial Institutions.

The Islamic banking and finance industry is currently at its pinnacle of growth. As at February 2011, total assets of the industry have reached US\$1 trillion<sup>2</sup>, and according to the report released by the McKinsey & Co. (2008), the industry has recorded an impressive growth rate of 20% to 30% per annum. Obviously, it attracts many conventional banks and financial institutions to also involve in the industry by offering their Islamic windows or subsidiaries to the markets. In the case of Indonesia, Islamic banking industry has been started since 1992 when the first Islamic bank in Indonesia, Bank Muamalat Indonesia (BMI), was incorporated. It remains the only Islamic commercial bank until 1999 when the government sees that BMI could survive during the 1997/1998 global financial crisis and finally establishes Bank Syariah Mandiri as the government first Islamic bank in Indonesia. To date, there are 11 Islamic commercial banks with 1215 branches and 23 Islamic windows of conventional banks with 262 branches. The number of Islamic rural banks also increased significantly from 92 in 2006 to 153 in 2011. In total, there are 1,877 branches of Islamic banks spread around

Indonesia to meet the needs of Muslims in the country. This evidences that Islamic banking market share is growing further in Indonesia.

Table 1.1

	1992	1999	2002	2006	2009	2011
Islamic commercial bank	1	2	2	3	6	11
Islamic windows	0	1	6	20	25	23
Islamic rural banks	9	78	83	92	139	153
Number of branches	1	40	127	637	1211	1877

*Source: Monthly report of Islamic banking performance in Indonesia (www.bi.go.id)*

Nowadays, Islamic banks have a strong competition with conventional bank because they are faced with different customer's expectation to receive high quality service that they can serve. Therefore, Islamic banks have to think about how they can improve their service to increase customers' perceive quality in compared with conventional bank (Abedniya & Zaeim, 2011). In addition, Parasuraman et.al in 1990 defined service quality as customer's perception of how well a service meets or exceed their expectation; accordingly service quality is judged by customer, not the companies or organization that offer them. According to Parasuraman et. Al. (1988), service is an intangible outcome that does not possess physical features. Instead, it is determined by its functions, performance and benefits it provides for people that pay money for it (Abedniya & Zaeim, 2011).

In Islamic banking sector in particular, marketers are faced by cultural and religious differences among people that reinforce the importance of building additional dimension for service quality (Abedniya & Zaeim, 2011). According to Othman and Owen (2001) introduce a dimension called Compliance for Islamic bank service quality. This dimension includes several items that are directly related to Islamic laws and principles. Muslim people are very sensitive to the Islamic rules especially in financial sector therefore, the advent to Islamic banking is very important for Islamic world that has much Muslim population (Abedniya & Zaeim, 2011).

The Islamic banking system (IBS) was introduced due to the reason that there was the need of financial institution for Muslim customers who could satisfy their needs and demands. Because the conventional banking industry is entirely based on the interest based system and that is prohibited in the Islamic Sharia rules. So the Muslims need such institute which provides them the Islamic platform for their financial transactions. Often Muslim people difficult to find a product or service that actually fit the Sharia (laws) of Islam. Islam creates an identifiable culture because it provides a way of life for people at both organizational and personal level. The challenges in doing business in Islamic countries thus come from the fact that Muslims have a different set of values and beliefs that guide their behavior in both business and non-business situations. The important of these sets value in this business have only recently come to the attention of world marketers.

Although the banking system has been in existence for over a half century, awareness on its products and services are hardly known by most people even though the majority of the Muslim communities are aware of such products and services. Furthermore, this lack of awareness has led to differing opinions on products and services offered by the Islamic banking. But in Indonesia, the awareness of Islamic Banking is quite high but the understanding about Islamic Banks is still not sufficient (Karim and Affif, n.d.). Khalaf (2007) argues that a product or services may be accepted by one individual and be considered un-Islamic by another, showing a major rift between the Muslim community and Non-Muslim.

Islamic products are very complex in nature as compared to conventional financial products. So far, religious principles being a very strong reason for customer's adoption of Islamic banking. It was found that religion will be affecting the awareness and understanding for Islamic banking products and services (Run and Yeo, n.d.). This might due to the actuality of Islamic Financing being based on Islam. Hence, Muslims who believe in Islam could understand the Islamic financing easier compared to non-Muslims who have not been exposed to Islam teachings. This creates a serious challenge to banks as they try to satisfy consumers who are non-Muslim by making sure they understand the benefits of each product to avoid conflicts (Cornish et al., 2012).

Customer perception on service quality and product is important since it is linked to the awareness. It is argued that the increasing perception of service

quality and quality of the product will increase customer awareness, which ultimately increase satisfaction (Bashir, 2012). Customer satisfaction often depends on the quality of product or service offering. In the context of services, some describe customer satisfaction as an antecedent of service quality (Alsoud & Abdallah, 2013; as cited in Cronin and Taylor; 1992). Service quality is thus related, though not equivalent, to satisfaction (Alsoud & Abdallah, 2013; as cited in Oliver, 1996). For this reason, research on customer satisfaction is often closely associated with the measurement of service quality (Alsoud & Abdallah, 2013; as cited from East; 1997). In addition, individual consumers are demanding for more Islamic products and services that meet their banking requirements. That's why Islamic banks are facing the challenge of developing new products and services that customer's needs and at the same time consistent and compliant with Sharia principles.

This research will be conduct in Islamic banking in Payakumbuh. Based on the description of the background that have been outline above, researches interested in conducting this research with the heading "The influence of Product Quality and Service Quality to Awareness as Intervening Variable Customer Satisfaction as intervening variable on Customer Loyalty in Islamic Bank in Payakumbuh."

## **1.2 Problem Statements**

This research will answer the question below:

1. How does product quality influence to awareness in Islamic banking in Payakumbuh?

2. How does service quality influence to awareness in Islamic banking in Payakumbuh.
3. How does awareness influence to customer satisfaction in Islamic banking in Payakumbuh?
4. How does product quality influence to customer satisfaction trough awareness in Islamic banking in Payakumbuh?
5. How does Service quality influence to customer satisfaction in Islamic banking in Payakumbuh?

### **1.3 Scope of The research**

Based on the problem statement, this research will be limited to explain and analyze the influence of product quality and service quality to awareness as intervening variable toward customer satisfaction in Islamic Banking in Payakumbuh such as Sharia Mandiri, Muamalat Bank, and Sharia Nagari.

### **1.4 Objective of the Research**

The objective of this research, as follows:

1. To determine the influence of product quality to awareness in Islamic banking in Payakumbuh.
2. To determine the influence of service quality to awareness in Islamic banking in Payakumbuh.
3. To determine the influence of awareness to customer satisfaction in Islamic banking in Payakumbuh.
4. To determine the influence of product quality to customer satisfaction trough awareness in Islamic banking in Payakumbuh.



5. To determine the influence of service quality to customer satisfaction in Islamic banking in Payakumbuh.

### **1.5 Contribution of The Research**

The contributions that expected of this research are, as follows :

- For the researcher

This research will useful for the researcher to understand and improve thinking skills especially in the field of factors that influence of customer satisfaction in the Islamic banking sector.

- For the institution

This purpose of this research is to analyze the factors that influence of customer satisfaction in Islamic banking sector. The institution can use this research to analyze the influence of customer satisfaction in Islamic banking and can develop their service, product that linked to the awareness in Islamic banking.

- For the next research

This research expected will become a reference for further research.

## **1.6 Outline of Research**

### CHAPTER I INTRODUCTION

Contains background and formulation of the problem, the objectives of research, the contribution of the research, and writing systematic thesis is used.

### CHAPTER 2 LITERATURE REVIEW

Contains theories include previous research, understanding the influence of product quality and service quality to awareness as intervening variable to customer satisfaction in Islamic banking, review past research and the research hypothesis.

### CHAPTER 3 RESEARCH METHOD

This chapter will explain the methodology of research, research design, population and sample, data collection and data analysis technique used.

### CHAPTER 4 RESULT AND DISCUSSION

This chapter will explain the result of research, and the discussion of result.

### CHAPTER 5 CONCLUSION

This chapter will explain the conclusion of research, limitation, implication and recommendation of the research.