# SERVICE QUALITY, CUSTOMER SATISFACTION AND LOYALTY IN COMMERCIAL BANKS IN KENYA

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# DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any university for academic credit

Signed: ……………………………. Date:…………………………………..

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This project has been presented for examination with our approval as the university supervisor.

Signed: ……………………………. Date:…………………………………..

**Mr. Ernest Akelo**

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# DEDICATION

This project paper is dedicated to my beloved family, Mr. Julius Wasonga and Mrs. Teresa Apiyo. To my four brothers who have always been my rock Crispus Otieno, Laban Ayuak, Geoffrey Ayieko and John Otho. I hope this inspires them to continue to achieve their goals.

# ABSTRACT

Service firms have increasingly recognized the role of customer loyalty in the creation and maintenance of competitive advantage. Customer loyalty positively influences firm performance. Keeping loyal customers is beneficial to organizational performance despite there being little agreement as the determinants of customer loyalty in commercial banks. Therefore, this paper examines the extent to which service quality and customer satisfaction influence customer loyalty in Commercial Banks. To achieve this, data was collected using a questionnaire from 300 respondents who were selected through stratified random and systematic sampling procedures. Data analysis was done through Pearson correlation and regression analysis. The findings revealed that there was a positive and significant relationship between service quality, customer satisfaction and customer loyalty. This study also found that service quality and customer satisfaction are critical success factors that influence the competitiveness of an organization. It is therefore recommended that banks should adopt the model consisting of the three constructs to create and maintain customer loyalty so as to improve performance and create competitive advantage.

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# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the study

Customer loyalty is very important in the creation and maintenance of competitive advantage in the service industry all over the world. The realization that there are many economic advantages attributed to retaining loyal customers as opposed to looking for new ones has made industry practitioners and academics pay much more attention to customer loyalty studies Ndubisi (2007). In order to remain competitive, commercial banks need to build and enhance customer relationships that deliver value beyond that provided by the core product (Zineldin, 2006). The benefits incurred from this approach include improved company performance, profitability, business referrals and increased publicity, customer share and competitive positioning (Hennig-Thurau et al., 2002).

Ensuring customer satisfaction and their long term retention is one of the most important tasks for the management of a service company. A high level of customer satisfaction is the main tool for creating long-term loyalty, business stability, growth and long term development of the company. Customer satisfaction is a very important aim and instrument for managing a modern company that is faced with new challenges in a contemporary environment. In the changing banking scenario of the 21st century, banks need to have a vital identity to provide excellent services. Banks have to be of world-class standard, committed to excellence in service delivery, and to play a major role in the growing and diversifying financial sector (Balachandran, 2005). There has been a remarkable change in the way of banking in the last few years.

In the banking sector, loyal customers are more profitable because they are attached to the bank and thus are easier to serve than the non-loyal customers. Bowen and Shoemaker (1998) maintain that a small increase in loyal customers can result in a substantial increase in profitability. Furthermore, the longer a loyal customer stays with a firm, the more profitable it is to that firm (Kim and Cha, 2002)

### 1.1.1 Service Quality

Quality can be defined as satisfying or exceeding customer requirements and expectations, and consequently to some extent it is the customer who eventually judges the quality of a product (Shen et al., 2000). Definitions of service quality hold that this is the result of the comparison that customers make between their expectations about a service and their perception of the way the service has been delivered or performed (Lehtinen & Lehtinen, 1982; Lewis & Booms, 1983; Gronroos, 1984; Parasuraman et al., 1985; Caruana, 2002). According to Zeithaman and Bitner (2003) service quality is a measure of how well a delivered service matches the customers' expectations.

Financial service providers, particularly banks, compete in the marketplace with generally undifferentiated products, therefore service quality becomes a primary competitive strategy Stafford (1996). Banks have realized the significance of concentrating on quality of services as an approach to increase the level of customer satisfaction and retention, and to develop their core competencies and business performance (Kunst & Lemmink, 2000).

### 1.1.2 Customer Satisfaction

Customer satisfaction is a well-known and established concept in several areas like marketing, consumer research, economic psychology, welfare-economics, and economics. The most common interpretations obtained from various authors show that satisfaction is a feeling which results from a process of evaluating what has been received against what was expected, including the purchase decision itself and the needs and wants associated with the purchase (Armstrong & Kotler, 1996). Bitner and Zeithaml (2003) stated that satisfaction is the customers' evaluation of a product or service in terms of whether that product or service has met their needs and expectations. According to Boselie, Hesselink, and Wiele (2002) satisfaction is a positive, affective state resulting from the appraisal of all aspects of a party's working relationship with eachother.

### 1.1.3 Customer Loyalty

Researchers have identified that customer loyalty as a construct is comprised of both customers' attitudes and behaviors. Customers' attitudinal component represents notions like: repurchase intention or purchasing additional products or services from the same company, willingness to recommend the company to others, demonstration of such commitment to the company by exhibiting a resistance to switching to another competitor (Cronin & Taylor,1992; Narayandas, 1996; Prus & Brandt,1995), and willingness to pay a price premium (Zeithaml, Berry, & Parasuraman,1996). On the other hand, the behavioral aspect of customer loyalty represents actual repeat purchase of products or services that includes purchasing more and different products or services from the same company, recommending the company to others, and reflecting a long-term choice probability for the brand (Feick, Lee, & Lee, 2001). It can be concluded that customer loyalty expresses an intended behavior related to the product or service or to the company. Pearson (1996) has defined customer loyalty as the mindset of the customers who hold favorable attitudes toward a company, commitment to repurchase the company's product/service, and recommend the product/service to others.

### 1.1.4 Customer Satisfaction and Loyalty

According to various literature, customer satisfaction with service exellence will lead to higher level of customer loyalty. Horstmann (1998), states that there is a strong and positive relationship between customer satisfaction and loyalty. A satisfied customer is six times more likely to repurchase a product and share his experience with five or six other people (Grönroos, 2000; Zairi, 2000). Tee et al. (2012) found a significant positive relationship between customer satisfaction and customer loyalty. Other several studies have indeed found satisfaction to be a leading factor in determining loyalty (Sit et al., 2009; Mensah, 2010). These studies assert that high level of customer satisfaction will result in increased loyalty for the firm and is positively associated with repurchase intentions, positive words of mouth and profitability.

### 1.1.5 Commercial Banks in Kenya

Banking is a business that is registered to accept deposits from the public and make out loans. Technically, banks mobilize funds from the surplus units and channel it to the deficit units of the economy (Luckett, 1994). The banking industry in Kenya is governed by the Banking Act of Kenya Cap 488. The Central Bank of Kenya (CBK) is responsible for formulating and implementing monetary policies directed at achieving and maintaining stability in the general price levels and fostering liquidity, solvency and proper functioning of a stable market-based financial system. As at the end of 31st December 2012, the number of financial institutions comprised of 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions and 4 representative offices of foreign banks.

The banking sector in Kenya has experienced drastic changes that have resulted in deregulation and liberalization, declining interest margins due to customer pressure, increased demand for non-traditional services including the automation of a large number of services and a move towards emphasis on the customer rather than the product, the introduction of non-traditional players who now offer financial services products. Many of these trends have resulted in mergers, acquisitions and reorganizations in the banking sector. This trend has been characterized by a low customer base and declining profitability (Levesque & McDougall, 1996). There are also significant developments in the banking sector that are affecting the marketing of their products.

All these changes have led to increased attention to customer relationships and service quality as a way of attracting, maintaining and enhancing long-term multiple service relationships. Many financial service providers are creating competitive advantage by differentiating their products from their competitors through quality service delivery in terms of on-time delivery, provision of accurate information, customization, trained personnel and quicker complaints resolution and service recovery processes. Therefore, delivery of superior service quality has become one of the most important strategies for customer retention and loyalty. Firms often attempt to improve service quality, satisfaction and to increase loyalty through innovations in products and services (Meidan, 1996), but such innovations are often imitated by competitors eventually.

## 1.2 Research Problem

Firms that have a goal to remain competitive in the marketplace, need to build and enhance relationships with loyal customers because of benefits that include profitability, business referral and publicity, customer share and competitive positioning (Hennih-Thurau et al., 2002). Given that it is increasingly becoming difficult to achieve customer loyalty in a competitive environment, researchers have attempted to develop models to investigate customer loyalty in a variety of contexts. In reviewing these models, it has been established that service quality, customer satisfaction, perceived value, trust and commitment are the most critical variables in creating and maintaining customer loyalty (Kim & Cha, 2002; Liang & Wang, 2005; Palmatier et al., 2006).

Cronin et al. (2000) points out that when service quality and satisfaction are investigated separately as drivers of loyalty outcome behaviors, they consistently have a statistically significant effect on loyalty. Chakravarty (2003) in his study on relationship and individual bank switching behavior in South Africa, found that there is a meaningful negative relation among service quality dimensions, responsiveness, empathy and reliability, with customer tendency to abandon the bank. On customers' abandonment behavior in banks in Kenya, (Wanjau et al., 2012) documented that service quality and customer satisfaction in the Public health sector in Kenya is determined by; low technology adoption, ineffective communication channels, insufficient funds and low employees capacity. Musyoka (2013) in his study of service quality and satisfaction among Kenyan Library users found that libraries that offered better customer services were more preferred by library users compared to libraries that offered poor customer service. Mburu (2013) did a study about the determinants of customer satisfaction in the Kenyan banking industry and documented that customer satisfaction is determined by factors such as pricing, quality of service, value and relationship with the service provider's staff.

Despite the recognition that service quality, customer satisfaction and value are important determinants of customer loyalty, critical research gaps remain regarding their combined effect in a single model on customer loyalty in commercial banking. Most of the previous studies focused on the single determinants of customer loyalty such as service quality, satisfaction, perceived value, trust, retention, customer loyalty programs, social capital, demographic variables as well as customer service in service firms. This study seeks to answer the following research questions: What are the service quality levels of commercial banks in Kenya? What are the levels of customer satisfaction with the services provided by commercial banks in Kenya? What is the relationship between service quality and customer satisfaction? What is the relationship between customer satisfaction and loyalty?

## 1.3 Objective of the Study

The principal objective is to evaluate literature on service quality which has been developed by different researchers that is applicable to different kinds of organizations, especially in the banking sector. To accomplish this, the study will cover the following specific objectives:

i. To determine the service quality levels of Commercial Banks in Kenya
ii. To establish the relationship between service quality and customer satisfaction in the banking sector.
iii. To establish the relationship between customer satisfaction and loyalty in the banking sector.

## 1.4 Value of the Study

The findings of this study intend to make theoretical, practical and methodological contributions to Operations management in the banking industry. Specifically, the findings will contribute to professional extension of existing knowledge in the theory of Operations Management by helping to understand the role of internal service quality management on the performance of organizations.

By measuring the satisfaction level of customers, commercial banks can develop customer-centric service approaches to deal with customers in order to avoid the tendency of existing customers switching to a competing bank. Policy makers in the field of Operations Management may use the findings of this study to come up with universally applicable strategies that can make internal service quality management aligned with the operations strategy of organizations and hence deliver the expectations of stakeholders and facilitate the attainment of strategic ambitions of both private and public organizations.

# CHAPTER TWO
# LITERATURE REVIEW

## 2.1 Introduction

This chapter reviews works done on Quality Management theoretically. The review focuses on the overview of the concept of quality, concept of service, service quality, service quality measurements and models, customer satisfaction, and the role of service quality in ensuring customer satisfaction and retention.

## 2.2 Theoretical Foundation

The theoretical model adopted for this study was derived from the Social Exchange Theory (Homans, 1958), which posits that all human relationships are formed by the use of cost-benefit analysis and comparisons of alternatives. The Social exchange theory attempts to explain the nature of the relationships between service quality, perceived value, satisfaction and loyalty. The theory indicates that individuals are willing to maintain relationships because of the expectation that to do so will be rewarding. Individuals voluntarily sacrifice their self - benefits and contribute these benefits to other individuals with the expectation for more future gains. Thibaut and Kelly (1959) propose that whether an individual retains a relationship with another one depends on the comparison between the current relationship, past experience and potential alternatives. The constant comparison of social and economic outcomes between a series of interactions with current partners and available alternatives determines the degree of an individual's commitment to the current relationship.

The theory is appropriate for this study because service encounters can be viewed as social exchanges with the interaction between service provider and customer being a crucial component of satisfaction and providing a strong reason for continuing a relationship (Barnes, 2007). Social exchange theory attempts to account for the development, growth and even dissolution of social as well as business relationships.

## 2.3 Service Quality

Service quality has been conceptualized as the difference between customer expectations regarding a service to be received and perceptions of the results of the service being received (Grönroos, 2001; Parasuraman, Zeithaml, & Berry, 1988). In some earlier studies, service quality has been referred to as the extent to which a service meets customers' needs or expectations (Lewis & Mitchell, 1990; Dotchin & Oakland, 1994). It is also conceptualized as the consumer's overall perception of the relative inferiority or superiority of the services (Zeithaml, Berry, & Parasuraman, 1990).

A number of factors or determinants have been identified in literature for measuring service quality. For instance, Sachev and Verma (2004) measure service quality in terms of customer perception, customer expectation, customer satisfaction, and customer attitude. Despite the numerous models for measuring service quality, (Nyeck et al., 2002) admit that the SERVQUAL model remains the most complete attempt to conceptualize and measure service quality. Therefore this study adopts the SERVQUAL dimensions to measure service quality among commercial banks in Kenya. The SERVQUAL dimensions: tangibles, reliability, responsiveness, assurance and empathy are the basis for service quality measurement (Parasuraman et al., 1988; Zeithaml et al., 1990).

Tangibles. The tangibles encompass the appearance of the firm's representatives, facilities, materials, and equipment as well as communication materials. The condition of the physical surroundings is seen as tangible evidence of care and attention to detail exhibited by the service provider (Fitzsimmons & Fitzsimmons, 2001). Davis et al. (2003) summarize tangibles as the physical evidence of the service.

Reliability. The reliability and consistency of performance of service facilities, goods and staff is very important in determining the quality of service (Johnston, 1997). This includes punctual service delivery and ability to keep to agreements made with the customer. According to Fitzsimmons and Fitzsimmons (2001), reliability is the ability to perform the promised service both dependably and accurately free of errors.

Responsiveness. Johnston (1997) describes responsiveness as the speed and timeliness of service delivery. This includes the speed of throughput and the ability of the service to respond promptly to customer service requests, with minimal waiting and queuing time. Fitzsimmons and Fitzsimmons (2001) argue that when the customer is kept waiting for no apparent reason creates unnecessary negative perceptions of quality. Conversely, the ability for the bank to recover quickly from service failures and exhibit professionalism while doing so will also create very positive perceptions of quality.

Assurance. This considers the knowledge and courtesy of employees as well as their ability to convey trust and confidence. The assurance dimension includes the following features: competence to perform the service, politeness and respect for the customer, effective communication with the customer and the general attitude that the service provider has the customer's best interest at heart (Fitzsimmons & Fitzsimmons, 2001).

Empathy: According to Chase et al. (2001), empathy is the provision of caring, individualized attention to customers. Fitzsimmons and Fitzsimmons (2001) posit that empathy includes approachability, sensitivity, and effort to understand the customer's needs. Johnston (1997) describes empathy as the ability to make the customer feel welcome, particularly by the contact staff. The SERVQUAL model identify a gap which maintains that satisfaction is related to the size and direction of disconfirmation of a customer's experience versus their initial expectations (Churchill & Surprenant, 1982; Parasuraman, Zeithaml & Berry, 1985; Smith & Houston, 1982).

## 2.4 Customer Satisfaction

Satisfaction is a feeling which results from a process of evaluating what has been received against what was expected, including the purchase decision itself and the needs and wants associated with the purchase (Armstrong & Kotler, 1996). Bitner and Zeithaml (2003) stated that satisfaction is the customers' evaluation of a product or service in terms of whether that product or service has met their needs and expectations. According to Boselie, Hesselink, and Wiele (2002), satisfaction is a positive, affective state resulting from the appraisal of all aspects of a party's working relationship with another. To protect or gain market share, organizations need to out-perform competitors by offering high quality product or service to ensure satisfaction of customers (Reichheld, 1996; Gronroos, 2000; Tsoukatos, 2008). With banks, customer longevity is achieved through the delivery of high quality services (Berry et al., 1985; Anderson et al., 1994; Lassar et al., 2000) especially under unregulated and volatile financial market conditions (Colgate & Lang, 2001).

The ability of a bank to meet the expectations of customers determines the extent of satisfaction derived by customers. Beerli et al. (2004) describes customer satisfaction as the measure of the extent a bank fulfills the general expectations of a customer and how far and/or close does the existing bank come to the customer's ideal bank in his mind. Customer satisfaction can be viewed as the future intentions of customers towards the service provider, which is more or less related to the attitude (Levesque et al., 1996). According to Hansemark and Albinsson (2004), "satisfaction is an overall customer attitude towards a service provider, or an emotional reaction to the difference between what customers anticipate and what they receive, regarding the fulfillment of some need, goal or desire". In order to maintain and increase purchases, the bank needs to provide value (high quality) to customers (Anderson & Jacobsen, 2000).

## 2.5 Customer Loyalty

Gremler and Brown (1996) define customer loyalty as the degree to which a customer exhibits repeat purchase behavior from a service provider, positive attitudinal disposition toward the provider, and ready to use the same provider again when a need for the service arises. According to Hoyer and MacInnis (2001), customer retention is the practice of working to satisfy customers needs with the intention of developing long-term relationships with them.

Loyalty in service businesses refers to the customer's commitment to do business with a particular organization, purchasing their products repeatedly and recommending others to the organization's products. Anderson and Jacobson (2000) say that customer loyalty is actually the result of an organization creating a benefit for customers so that they will maintain or increase their purchases from the organization. They indicate that true loyalty is created when the customer becomes an advocate for the organization without incentives.

According to Clark (2001), long-term customer retention in competitive markets requires the provider going beyond basic satisfaction to creating loyalty in order to guard against competitor attack. Day (1994), contends that the identification and satisfaction of customer needs leads to improved customer retention.

## 2.6 Service Quality and Customer Satisfaction

Sureshchandar et al. (2003), identified that a strong relationship exists between service quality and customer satisfaction while emphasizing that these two are conceptually distinct constructs from the customers' point of view. Spreng and Mackoy (1996) also showed that service quality leads to customer satisfaction while working on the model developed by Oliver (1997). With the ever increasing competition in the marketplace resulting from trade liberalization and free economy model, it is imperative for banks to achieve customer longevity through excellent service delivery (Lassar et al., 2000).

Service quality is recognized as potential for ensuring customer satisfaction and retention, operational efficiency and profitability of an organization (Cronin, 2003). File and Prince (1992) argue that satisfied customers are comfortable repeating business with the firm and even recommend it to others. The customers sell the company to others by word-of-mouth when they are satisfied with the services (Gee et al., 2008) and thus increase firm's customer-base. Parallel to this, is the study by Martins and Toledo (2000), which maintains that service quality increases market share by maintaining current customers and acquiring new ones. Krishnan et al. (1999) establish that the cost of retaining existing customers by providing high quality products and services is significantly lower than the cost of winning new customers.

Success of a service provider depends on the high quality relationship with customers (Panda, 2003) which determines customer satisfaction and loyalty (Jones, 2002). Research has shown repeatedly that service quality influences organizational outcome such as performance superiority (Poretla & Thanassoulis, 2005), increasing sales profit (Levesque & Mc. Dougal, 1996; Kish, 2000) and market share (Fisher, 2001), improving customer relations, enhance corporate image and promote customer loyalty (Newman, 2001; Caruana, 2002). Furthermore, service quality and customer satisfaction were found to be related to customer loyalty through repurchase intentions (Levesque & McDougall, 1996). Delivering quality service to customers is a must for success and survival in today's competitive banking environment.

## 2.7 Customer Satisfaction and Loyalty

Numerous studies in the service sector have empirically validated the link between satisfaction and behavioral intentions such as customer loyalty and word of mouth (Anderson & Sullivan, 1993; Bansal & Tay- lor, 1999; Cronin & Taylor, 2000). Hart and Johnson (1999) have added that one of the conditions of true customer loyalty is total satisfaction. Most customers leave a company because they feel they are not satisfied with the service or product offering (Rust & Zahorik, 1993). Hoyer and MacInnis (2001) said that satisfaction can be associated with feelings of acceptance, happiness, relief, excitement, and delight of a service. Thus extremely satisfied customers are less prone to overtures from competition (Fornell, 1992). Similarly Anton (1996) asserts that satisfaction is positively associated with repurchase intentions and the likelihood to recommend a product or service offering.

Literature establishes that customer satisfaction has a strong positive correlation with customer retention in the retail banking sector (Siddiqi, 2010; Kandampully & Suhartanto, 2000). The strong positive correlation means the customers will recommend the bank to other people. As a consequence, the bank can be assured of repeat and stable customer base. Cohen et al. (2007) found that a loyal customer takes less of the company's time during transactions and are less sensitive to price changes. Reichheld (2006) states that companies with higher customer loyalty experience growth in revenue twice as much as their competitor.

These discussions indicate that satisfaction is a determinant of customer retention/loyalty to service organizations like banks. Rust and Zahorik (1993) conclude that numerous publications treat satisfaction as the necessary premise for customer retention.

## 2.8 Summary of Literature Review and Conceptual Framework

The aim of this section is to summarize the ideas gotten from past literature and to bring out the contributions the researcher has for this study area. Thus this part starts with the idea generated and the contribution follows. The general idea from the past literature is that there is a relationship between customer satisfaction and service quality; also that service quality could be evaluated with the use of five service quality dimensions and the most useable is the SERVQUAL scale. Following the two clarifications about the different views of customer satisfaction of a customer of either being transaction-specific or cumulative (Boulding et al., 1993; Andreassen, 2000). My theoretical frame work treats customer satisfaction as transaction-specific. Thus, customers in this paper are those who consume the services, satisfaction denotes customer's desire to maintain a business relationship with the organization and it is also the feelings of the customers towards the services provided to them by the organizations; while customer satisfaction in this study is the pleasures obtained by customers for the services provided to them by the employees of the organizations. It has been proven that perceived service quality is a component of customer satisfaction (Ziethaml et al., 2006). Other researchers had proven also that there is a relationship between customer satisfaction and service quality (Sivadas & Baker-Prewitt, 2000; Wang et al., 2002; Kuo-YF, 2003; Liang & Zhang, 2009; Gera, 2011; Sureshchandar, et al., 2002). Moreover, the SERVQUAL model has been proven to be the best model to measure service quality in service sectors especially with the customer perspective. This idea generates an assumption that the five dimensions of SERVQUAL model could have a direct relationship with customer satisfaction.

The questions that arose from this assumption is that 'Is there a significant relationship between customer satisfaction and service quality dimensions and customer loyalty? Also, it has been stated that service quality is the overall assessment of a service by the customers, (Eshghi et al., 2008). Also, the five dimensions of SERVQUAL model has been proven to be the main yardstick used by most of the researchers in the evaluation of service quality (Wilson et al., 2008; Bennett & Barkensjo; 2005, Negi, 2009; Wang & Hing-Po, 2002). This idea generates an assumption that each of the five dimensions of SERVQUAL model could have a direct relationship with service quality (Figure 2.1). The question that arose from this assumption is that: ´Is there a significant relationship between the five dimensions of SERVQUAL model and customer satisfaction that then leads to loyalty?

The below framework was developed using path analysis with Structural Equation Modelling (SEM). SEM is a methodology for representing, estimating and testing a theoretical network of (mostly) linear relations between variables, Rigdon (1998).

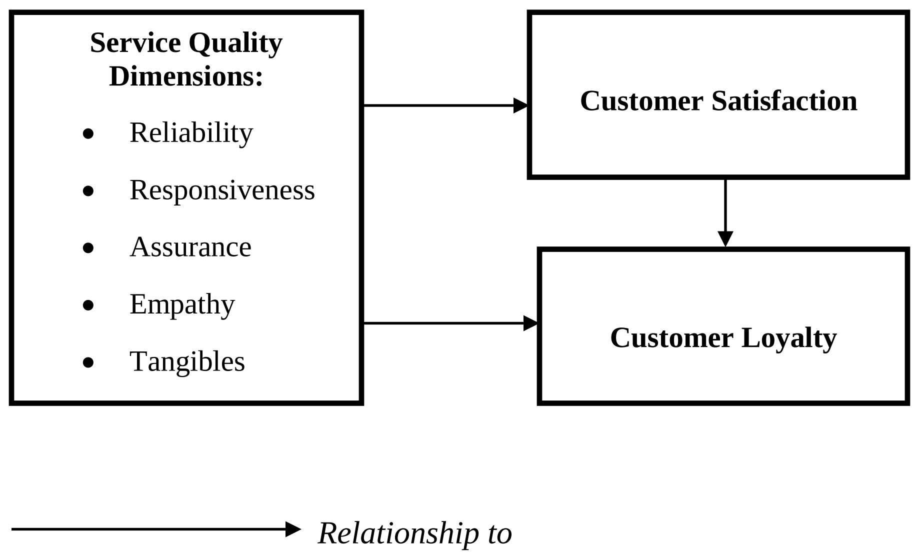


***Figure 2.1: Conceptual framework of the study***

*Source: Own compilation*

# CHAPTER THREE: RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter presents research design, describes the research methods, sampling techniques and the instruments employed in the data gathering. The data analysis techniques, expected outputs and information presentation methods are discussed.

## 3.2 Research Design

A descriptive survey research design was used. A descriptive research design helps to ascertain and be able to describe the characteristics of the variables of interest in a situation and portrays the characteristics of a particular situation and it has the advantages of accuracy and flexibility (Kombo & Tromp, 2006).

## 3.3 Population of the Study

The target population for this study consists of 43 commercial Banks (CBK, 2013). Commercial Banks in Kenya are classified in terms of asset base into 3 Tiers consisting of 6 large commercial banks, 14 medium commercial banks and 23 small commercial banks.

## 3.4 Sample Design

The respondents for this study were the customers of various commercial banks. The commercial banks for this study were purposely selected to capture three categories of banks: Tier 1, Tier 2 and Tier 3. This categorization will assist in investigating whether the type of bank has an influence on service quality, customer satisfaction, and customer loyalty. A sample of 30 banks was selected using proportionate stratified sampling method. The population will be stratified according to asset base (Tier 1, Tier 2 & Tier 3).

$$\mathbf{n_h = ( N_h / N ) * n}$$

where: $\mathbf{n_h}$ is the sample size for stratum ***h***, $\mathbf{N_h}$ is the population size for stratum ***h***, **N** is total population size, and **n** is total sample size.

The table below shows the population and the sample selection from each tier.

**Table 3.1: Population sampling**

| Tier | Population | Sample |
|---|---|---|
| 1 | 6 | 4 |
| 2 | 14 | 10 |
| 3 | 23 | 16 |
| **Total** | **43** | **30** |

The researcher then used systematic random sampling technique to target 10 customers from each of the selected commercial banks. The total sample size was 300 respondents.

## 3.5 Data Collection

Primary data was used for the study and data was collected using a questionnaire which was administered to bank customers on their way out of the bank. The questionnaire items were constructed based on the literature on service quality, satisfaction and loyalty.

The questionnaire was used to collect data on demographic variables such as age, gender, education, marital status, occupation and income and to measure the levels of service quality, satisfaction, value, customer social capital and loyalty of the respondents. The items were constructed based on the literature on service quality, satisfaction and loyalty. Customer loyalty (dependent Variable) items were selected based on observable behavior characteristics including repurchase, referrals, citizenship behavior, co-production, willingness to pay premium price, less switching behavior, mentoring other customers and advocacy or word of mouth. The selection of these items ensure completeness in covering all key aspects of loyalty outcome behaviors.

The following table defines the various sections of the questionnaire:

**Table 3.2: Questionnaire Description**

| Section | Description |
|---|---|
| A | General Information |
| B | Determinants of Customer Satisfaction |
| C | Indicators of Customer Loyalty |

## 3.6 Data Analysis

Data analysis involved correlation and regression analysis. Pearson correlation analysis was conducted to determine the direction, strength and significance of the bivariate relationships between service quality, customer satisfaction and customer loyalty.

The study of the relationship between **service quality and customer satisfaction** was analyzed through a simple linear model which was used to observe the effect of service quality in predicting the variations in customer satisfaction. In the following model, customer Satisfaction (CS) is the dependent variable and service quality (SQ) is the independent variable, $\beta 0$ is the intercept or constant, $\beta 1$ is the slope, SQ is service quality and $\varepsilon$ is the error term.

$$\mathbf{CS = \beta 0 + \beta 1\ (SQ) + \varepsilon}$$

To further assess the effect of **customer satisfaction on customer loyalty,** a simple regression was used to observe the effect of customer satisfaction in predicting the variations in customer loyalty. The model presented below shows customer loyalty as the dependent variable and customer satisfaction (CS) as independent variable, $\beta 0$ is the intercept or constant, $\beta 1$ is the slope, CS is customer satisfaction and $\varepsilon$ is the error term

$$\mathbf{CL = \beta 0 + \beta 1\ (CS) + \varepsilon}$$

To verify the composite effect of the two constructs, the following regression model was used to test the relationship between service quality, customer satisfaction and customer loyalty.

$$\mathbf{CL = \beta 0 + \beta 1SQ + \beta 2CS + \varepsilon}$$

Where: **β0** is the intercept or constant, **β1, β2, β3** are the regression coefficients or slope of the regression line of the independent variables 1 to 3. They indicate the relationship between the independent variables and the dependent variables.**CL** is customer loyalty, **SQ** is service quality, **CS** is customer satisfaction and **ε** is the error/ random term. It represents errors that could arise due to random behavior

# CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

## 4.1 Introduction

This chapter contains analysis of the findings from the study. The chapter analyses the data systematically by focusing on the study objectives: To determine the service quality levels of Commercial Banks in Kenya, to establish the relationship between service quality and customer satisfaction in the banking sector, to establish the relationship between customer satisfaction and loyalty in the banking sector. The findings are presented as a report of the questions answered by the respondents.

## 4.2 Response Rate

With the initial descriptive analysis, the results showed that all the 300 respondents in the sample provided their responses. The response rate was 100% since the methods of data collection used were effective. This involved giving the respondent questionnaire and waiting for it to be filled out before moving to the next respondent. There was also online data collection where the questionnaire was emailed to various respondents.

## 4.3 General Information

The general information sought in this study were, names of the banks, respondent's gender, age group and level of education achieved.

Majority of the respondents were male amounting to 174 while 126 were female. This indicates that the sample was well distributed hence the responses received expressed views of both sexes.

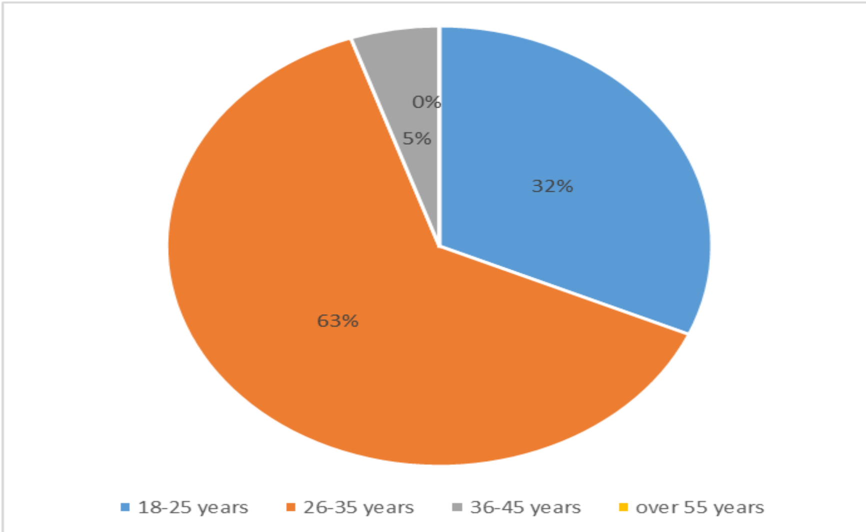


***Figure 4.1 Age distribution of respondents***

Majority of the respondents (63%) were aged between 26-35 years while (32%) were aged between 18-25 years. A few (5%) were between 36 - 45 years. None was over 55 years. This means that the study sampled respondents from a variety of age groups and the views expressed belong mostly to the youth.

The academic qualification of the respondents is important as it helps to determine the respondent's general understanding of the operations of banks which then helps them to know the trends in the market and compare services.

**Table 4.1 Academic qualification of the respondents**

| Education level | Frequency | Percentage |
|---|---|---|
| College | 21 | 7% |
| Bachelor's degree | 237 | 79% |
| Master's degree | 42 | 14% |
| **Total** | **300** | **100%** |

Majority of the respondents (79%) had Bachelor's degree as their highest level of education. They were followed by respondents with master's degree accounting for 14% as their highest level of education. The rest had college qualifications. This implies that the respondents had a fair understanding of service quality, customer satisfaction and loyalty is commercial banks in Kenya.

## 4.4 Service Quality Levels of Commercial Banks

This study investigated service quality levels in Commercial banks by examining whether the bank's employees are consistently courteous with customers, if the employees have adequate knowledge to answer customer questions and whether the staff are able to communicate clearly with customers. The study also sought to find out if the employees understand specific customer needs and if they are willing to help customers at all times. Table 4.2 shows the results obtained from the respondents.

**Table 4.2 Service Quality Levels of Commercial Banks**

| Construct | Mean | Standard deviation |
|---|---|---|
| The employees are consistently courteous with customers | 4.21 | 1.25 |
| The employees have adequate knowledge to answer customers' questions | 4.45 | 1.12 |
| The staff are able to communicate clearly with customers | 4.18 | 1.65 |
| The employees understand customers' specific needs | 4.37 | 1.21 |
| The bank employees are always willing to help me | 4.81 | 1.91 |

From the findings, majority of the respondents agreed that the employees are consistently courteous with the customers as shown by a mean of 4.21 and standard deviation of 1.25. This means that the banks service quality is pleasing to many and therefore the bank should better the service quality for the sake of the few who are not comfortable with it. From Table 4.2, majority of the respondents agreed that the employees had adequate knowledge to answer customers' questions as revealed by a mean of 4.45 and standard deviation of 1.12. This means that the banks service quality is terms of employees being knowledgeable is okay with most of the customers. Majority of the respondents agreed that the staff are able to communicate clearly with customers as shown by a mean of 4.18

and standard deviation of 1.65. This means that the banks service quality is terms of communication by staff was satisfactory to customers.

Majority of the respondents indicated that they agreed that the employees of the banks understood specific customer needs as indicated by a mean of 4.37 and standard deviation of 1.21. This means that the commercial banks offer service quality in terms of understanding what the customers want. Table 4.2 indicates that majority of the respondents revealed that they agreed that the bank employees were willing to help them as shown by a mean of 4.81 and standard deviation of 1.91. This means that the commercial banks offer quality service in terms of employees being willing to help the customers.

The bank customers in Kenya prefer a friendly bank, which is willing to help in their banking operations. Willingness to help customers is likely to have an important and positive effect on customer loyalty in the retail banking sector in Kenya. Rachillo (2013) also found that the service levels of banks in Kenya are satisfactory to customers though constant improvements should be done to increase competitive advantage.

## 4.5 Relationship between Service Quality and Customer Satisfaction

The researcher investigate the relationship between the service quality and customer satisfaction by examining if the bank the bank keenly listens to customers and take appropriate action making them feel valued, if the bank meets its promises on certain service by a certain time, if The banks physical appearance is appealing. The study probed if the bank employees give prompt service and if the bank always performs the service right the first time. The bank deliverance of overall excellent service was also examined. The study found out if the services offered by the banks were of high quality and if the service deliverance was superior in every way.

**Table 4.3 Relationship between Service Quality and Customer Satisfaction**

| Construct | Mean | Standard deviation |
|---|---|---|
| The bank keenly listens to customers and take appropriate action making me feel valued | 4.73 | 1.88 |
| When the bank promises a certain service by a certain time, it delivers | 4.39 | 1.28 |
| The banks physical appearance is appealing | 4.28 | 1.51 |
| The bank employees give me prompt service | 4.19 | 1.72 |
| My bank always performs the service right the first time | 4.21 | 1.27 |
| My bank always delivers excellent overall service | 4.39 | 1.30 |
| The services offered by my bank are of high quality | 4.18 | 1.43 |
| My bank delivers superior service in every way | 3.04 | 2.10 |

Table 4.3 indicates that majority of the respondents revealed that they agreed that the bank employees keenly listens to them and take appropriate action that make them feel valued as shown by a mean of 4.73 and standard deviation of 1.88. This means that the commercial banks offer quality service in terms of customer service. The table indicates that majority of the respondents revealed that they agreed that the bank delivers promises made of certain service on time as indicated by a mean of 4.39 and standard deviation of 1.28. This means that the commercial banks offer quality service in terms of fulfilling their promise made to customers. Majority of the respondents indicated that they agreed that the banks physical appearance was appealing as shown by a mean of 4.28 and standard deviation of 1.51. This means that the commercial banks physical appearance is appealing to their customers.

Majority of the respondents indicated that they agreed the bank offered a prompt service as revealed by a mean of 4.19 and standard deviation of 1.72. This means that the commercial offer prompt service to most of their customers. Most of the respondents indicated that they agreed that the bank always performs the service right the first time as shown by a mean of 4.21 and standard deviation of 1.27. This means that the commercial banks offer quality service to her customers.

Table 4.3 indicates that majority of the respondents revealed that they agreed that the bank always delivers overall excellent service as shown by a mean of 4.31 and standard deviation of 1.30. This means that the commercial banks offer quality services. Majority of the respondents revealed that the service offered by the banks are of high quality as shown by a mean of 4.18 and standard deviation of 1.43. This means that the commercial banks offer quality services to their customers. Majority of the respondents revealed that they were undecided that their banks delivered superior services in every way as shown by a mean of 3.04 and standard deviation of 2.10.

The findings show that service quality has a significant contribution to customer satisfaction in the banking industry. This is supported by Onwonga et al. (2013), who stated that reliability and empathy are the most important service quality dimensions that contribute to customer satisfaction in retail banks in Kenya.

## 4.6 Relationship between Customer Satisfaction and Loyalty

The study sought to determine the relationship between customer satisfaction and loyalty by investigating if the customers find the performance of their banks repeatedly superior to that of their competitors. The study investigated if the customers felt very pleased with the services offered by their banks, if the bank offers a good variety of products and services that suit their needs, whether the bank interest rates are satisfactory and if the bank charges for various products and services are satisfactory. The study sought customers' opinions on the advertisements and promotions done by their bank and whether they were at variance with the actual experience and if the bank has operating hours and locations convenient to its customers. The researcher probed if the customers believed in their banks credibility and if employees instill confidence in them. Lastly the researcher examined if they had more than one bank account which would signify the level of satisfaction with their banks. Table 4.4 below shows the results received from the respondents regarding the questions relating to satisfaction.

**Table 4.4 Relationship between Customer Satisfaction and Loyalty**

| **Construct** | **Mean** | **Standard deviation** |
|---|---|---|
| Repeatedly, the performance of this bank is superior to that of competitors | 4.12 | 1.34 |
| I feel very pleased with services offered by my bank | 4.54 | 1.21 |
| The bank offers a good variety of products and services that suit my needs | 4.11 | 1.32 |
| The bank's interest rates are satisfactory | 3.20 | 1.78 |
| The bank charges for various products and services are satisfactory | 4.19 | 1.72 |
| Advertisements and promotions are not at variance with the actual service experience | 4.37 | 1.19 |
| My bank has operating hours and location convenient to all its customers | 4.48 | 1.87 |
| The employees instil confidence in customers | 4.62 | 1.72 |

Table 4.4 indicates that majority of the respondents revealed that they agreed that the bank performance of this bank is repeatedly superior to that of the competitors as shown by a mean of 4.12 and standard deviation of 1.34. This means that most of the customers are satisfied with the performance of their banks. Majority of the respondents revealed that they agreed that they felt very pleased with the services offered by their banks as revealed by a mean of 4.54 and standard deviation of 1.21. This means that the commercial banks offer quality services to her customers. Table 4.4 indicates that majority of the respondents revealed that the bank offers a good variety of products and services that suits their needs as indicated by a mean of 4.11 and standard deviation of

1.32. This means that the commercial banks offer quality services that meets the customer’s needs.

Majority of the respondents revealed that they were undecided that their banks interest rates were satisfactory as shown by a mean of 3.20 and standard deviation of 1.78 while a few agreed that they were satisfied with the interest rates. This means that the commercial banks services are not viewed as superior in every way. Table 4.4 indicates that majority of the respondents revealed that they agreed that the bank charges for various products and services are satisfactory as shown by a mean of 4.19 and standard deviation of 1.72. This means that the commercial banks charges on various products and services and not good with the customers. The findings indicated that majority of the respondents agreed that advertisements and promotions are not at variance with the actual as shown by a mean of 4.37 and standard deviation of 1.19. This means that the customers do not find what is in the banks as what they saw in the advertisements and hence they might be a disappointment lot.

Majority of the respondents revealed that the bank has operating hours and location convenient to all its customers as shown by a mean of 4.48 and standard deviation of 1.87. This means that the commercial banks services are viewed to offer quality service in terms on timings. Majority of the respondents revealed that the employees of the commercial banks usually instil discipline in customers as shown by a mean of 4.62 and standard deviation of 1.72. This means that some customers of the commercial banks have no confidence with their commercial banks.

In order to determine the level of satisfaction and loyalty that customers have for their banks, the respondents were asked whether they have more than one bank account and if they would recommend their bank to other people. The results indicate that majority of the respondents, 174 to be exact, have other bank accounts while the rest, 42%, did not have other bank accounts. This means that the customers have needs that they feel are not being satisfied by having one bank so they opt to have other bank accounts. However, 42% is also a fair enough number to show that banks need to put in slightly more effort to increase loyalty among customers. According McIlroy and Barnett (2000), an important factor to be considered when developing a customer loyalty program is customer satisfaction. Retail banks in Kenya should promote loyalty programs in order to reduce the 42% who are multi banked.

## 4.7 Correlation and Integration Results

Service quality was hypothesized as having an effect on customer loyalty in commercial banking. An index for service quality was calculated to represent all the items that were used to measure this construct. The customer loyalty index and the service quality index were used to test the relationship between the two constructs. Correlation analysis and regression analysis were used to test the relationship between service quality and customer loyalty.

The result of Pearson correlation analysis is provided in Table 4.5.

**Table 4.5: Correlations between service quality, customer satisfaction and customer loyalty**

| | | SERVINDEX | LOYINDEX | SATINDEX |
|---|---|---|---|---|
| **SERVINDEX** | Pearson correlation | 1.00 | 0.445** | 0.698** |
| | Sig. (2-tailed) | | 0.00 | 0.00 |
| | N | 384.00 | 384.00 | 384.00 |
| **LOYINDEX** | Pearson correlation | 0.445** | 1.00 | 0.486** |
| | Sig. (2-tailed) | 0.00 | | 0.00 |
| | N | 384.00 | 384.00 | 384.00 |
| **SATINDEX** | Pearson correlation | 0.698** | 0.486** | 1.00 |
| | Sig. (2-tailed) | 0.00 | 0.00 | |
| | N | 384.00 | 384.00 | 384.00 |

The results show that service quality is significantly, positively correlated to loyalty. The result shows a coefficient of 0.445 at $p = 0.01$ ($r = 0.445$, $p < 0.01$) which shows that the two constructs, service quality and loyalty are positively related. The coefficient of determination ($R^2$) shows that there is a significant positive relationship of 19.8%.

## 4.8 Regression Analysis

The study of the relationship between service quality and customer loyalty was further analyzed through a simple linear regression model which was used to observe the effect of service quality in predicting the variations in customer loyalty. The following model, customer loyalty (CL) was the dependent variable and service quality (SQ) was the independent variable:

Customer loyalty (CL) = $\beta o + \beta 1$ (SQ) + $\varepsilon$

Where: CL = customer loyalty

$\beta o$ = Intercept or constant

$\beta 1$ = Slope

SQ = Service quality

$\varepsilon$ = Error or random term.

The results for the model are shown in Table 4.6.

**Table 4.6: Regression Result for Service Quality and Customer Loyalty**

| R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | |
|---|---|---|---|---|---|---|---|
| | | | | F Change | df1 | df2 | Sig. F Change |
| 0.78 | .6084 | .56 | .64593 | 2.970 | 1 | 104 | .0431 |

| Model | Sum of squares | Df | Mean Square | F | Sig |
|---|---|---|---|---|---|
| Regression | 49.136 | 1 | 12.5243 | 23.871 | $0.00^{b}$ |
| Residual | 28.821 | 299 | 0.6291 | | |
| Total | 77.957 | 300 | | | |

| | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|
| Model | B | Std. Error | Beta | T | Sig. |
| (Constant) | .512 | .160 | | 3.4 | .022 |
| Service quality | .85931 | .357 | .0.234 | 2.333 | .010 |

The results indicate that service quality and customer loyalty are positively and significantly associated 0.010 ($p<0.05$). A statistical significance (F-value = 25.871; p= 0.01) was determined. $R^2$ was 0.6084 or 60% which was significant at 0.001 level. This implies that service quality explained about 60% of the variation in customer loyalty. This study established that customer loyalty to commercial banks was dependent on service quality. This result has satisfied the third objective of this study.

The results are consistent with studies that suggest that service quality might have a direct impact on customer loyalty (Parasuraman et al., 1991). Cronin and Taylor (1994) hypothesize that perceived service quality positively affects consumers' loyalty. Reichheld and Sasser (1990) and Cronin et al. (2000) found that good service quality leads to the retention of existing customers and the attraction of new ones, reduced costs, an enhanced corporate image, positive word-of-mouth recommendation, and ultimately enhanced profitability. They further established that service quality results in repeated sales and increased market share, which leads to customer loyalty. A research by Zeithaml et al. (1996) concluded that when organizations enhance the quality of their services, customers' favorable behavioral intentions are increased while unfavorable intentions are decreased simultaneously.

The findings further support previous studies on the direct link between service quality and customer loyalty (Bolton & Drew, 1991). Service quality has been found to have considerable impact in determining repeat purchase and customer loyalty (Jones & Farquhar, 2003). They pointed out that service quality influences a customer's subsequent behavior, intentions and preferences. When a customer chooses a provider that delivers service quality that meets or exceeds his or her expectations, he or she is more than likely choose the same provider again. Besides, Cronin and Taylor (1994) also found that service quality has a significant effect on repurchase intentions. Other studies which support that repurchase intentions are positively influenced by service quality include that of Cronin et al. (2000) and Choi et al. (2004). They established that a positive perception of service quality is an antecedent to customer loyalty. They further found that evaluative judgments of service quality could significantly influence service loyalty and bank loyalty.

A further analysis of the relative importance of the service quality dimensions was done using a regression model. Table 4.7 shows the results of the regression model.

**Table 4.7: Regression Results for the Service Quality Dimensions**

| **a) Model Summary** | | | | |
|---|---|---|---|---|
| **Model** | **R** | **R Square** | **Adjusted R Square** | **Std. error of the estimate** |
| 1 | 0.83044[a] | 0.6897 | 0.61 | 3.40806 |

| **ANOVA[b]** | | | | | | |
|---|---|---|---|---|---|---|
| **Model** | | **Sum of squares** | **Df** | **Mean square** | **F** | **Sig** |
| 1 | Regression | 1139.06 | 5 | 227.81 | 19.614 | 0.000[a] |
| | Residual | 4390.42 | 37 | 11.61 | | |
| | Total | 5529.49 | 383 | | | |

| **c) Coefficients** | | | | | | |
|---|---|---|---|---|---|---|
| **Model** | | **Unstandardized coefficients** | | **Standardized coefficients** | | |
| | | **B** | **Std. Error** | **Beta** | **T** | **Sig.** |
| 1 | Constant | 19.671 | 1.273 | - | 15.45 | 0 |
| | Tangibility | 0.074 | 0.056 | 0.079 | 1.324 | 0.01 |
| | Assurance | 0.171 | 0.116 | 0.093 | 1.481 | 0.02 |
| | Empathy | 0.191 | 0.115 | 0.1 | 1.663 | 0.04 |
| | Reliability | 0.23 | 0.063 | 0.257 | 3.668 | 0 |
| | Responsiveness | 0.023 | 0.08 | 0.021 | 0.292 | 0.03 |

The results revealed a statistical significance (F- value = 19.61; p = 0.000, $R^2$ was 0.6897 or 68%) which was significant at 0.05 level. This implied that these dimensions which measured service quality accounted for about 68% of the variation in customer loyalty in this model. This study established that customer loyalty to a bank will be strongly influenced by service quality.

It can be observed from Table 4.3(c) that using beta values to measure the variation in customer loyalty indicated that reliability (($\beta$ = 0.257) contributed to the highest variability followed by empathy (($\beta$ = 0.100), assurance (($\beta$ = 0.093), tangibility ($\beta$ = 0.079) and responsiveness (($\beta$ = 0.021), respectively.

This implies that customers are concerned with the bank personnel's ability to deliver the service in a dependable and accurate manner. These were captured in the research instrument as bank honors its promises all the time, bank always performs services right the first time, bank insists on error free documentation, bank offers quality products and services always, bank employees always keep their promises and bank's contracts have clear terms. Thus reliability is used in the evaluation of service and normally is the most important attribute consumers seek in the area of quality service (Parasuraman et al., 1991).

The result of Pearson correlation analysis provided in Table 4.1 shows that service quality is significantly, positively correlated to loyalty. The matrix shows a coefficient of 0.486 which shows that the two constructs, satisfaction and loyalty are positively related. The result shows that there is a significant positive correlation between customer satisfaction and customer loyalty. ($r$ = 0.486, $p<$ 0.01) implies that relationship between customer satisfaction and customer loyalty is positive. The coefficient of determination ($R^2$) shows that the relationship is significant at 23.6%. The second objective was to establish the relationship between service quality and customer satisfaction in the banking sector. The above results satisfy the objective.

To further assess the effect of customer satisfaction on customer loyalty, a simple regression was used to observe the effect of customer in predicting the variations in customer loyalty. The model presented as follows shows customer loyalty as the dependent variable and customer satisfaction (CS) as independent variable:

Customer loyalty = $\beta o + \beta 1$ (CS) + $\varepsilon$

Where: CL = customer loyalty

$\beta o$ = Intercept or constant

$\beta 1$ = Slope

CS = Customer satisfaction

ε = Error or random term

The results for the model are shown in Table 4.18.

**Table 4.8: Regression Result for Customer Satisfaction and Customer Loyalty**

| R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics F Change | df1 | df2 | Durbin-Watson |
|---|---|---|---|---|---|---|---|
| 0.81 | .6561 | .61 | .73931 | 23.874 | 14 | 106 | 2.071 |

| Model | Sum of squares | df | Mean Square | F | Sig |
|---|---|---|---|---|---|
| Regression | 49.2661 | 1 | 14.5915 | 23.874 | 0.00[b] |
| Residual | 38.2442 | 299 | 0.4172 | | |
| Total | 87.5103 | 300 | | | |

| Model | Unstandardized Coefficients B | Std. Error | Standardized Coefficients Beta | T | Sig. |
|---|---|---|---|---|---|
| (Constant) | .632 | .160 | | 3.2 | .022 |
| Customer satisfaction | 1.253 | .457 | .123 | 2.781 | 0.04 |

*Dependent variable: Customer loyalty*

The results indicated that customer satisfaction and customer loyalty were positively and significantly associated at 0.04 level ($p < 0.05$). A statistical significance (F= 1,299; $p<0.01$) was determined. $R^2$ was 0.6561 or 65% which was significant at 0.05 level. This implied that customer satisfaction explained about 65% of the variation in customer loyalty.

This finding concurs with Cheng et al. (2008) who found that there is a strong positive correlation between customer satisfaction and customer loyalty. Most of the researchers found that customer satisfaction is the predictor of customer loyalty (Leverin &

Liljander, 2006; Terblanche & Boshoff 2006). They found that customer satisfaction and customer loyalty are positively correlated.

This finding is also consistent with several previous studies by Sirdeshmukh et al. (2002). Lam et al. (2005) found a positive relationship between customer and satisfaction and customer loyalty. Many studies have shown that customer satisfaction affects variables that are indicators of customer loyalty or orientation toward a long-term relationship (Mittal & Kamakura, 2001). A satisfied customer's affect toward a service provider could motivate the customer to patronize the provider again and recommend the provider to other customers. This study confirms that customer satisfaction has a positive effect on customer loyalty dimensions. The form of relationship between customer satisfaction and repeat patronage could be nonlinear.

Bowen and Chen (2001) also point out that a small increase of customer satisfaction leads to an increase in customer loyalty. This current study finds that customer satisfaction has a large positive correlation with customer loyalty in the retail banking sector in Nairobi. Kandampully and Suhartanto (2000) also concurred with the finding on the relationship between satisfaction and customer loyalty.

The strong positive correlation of customer satisfaction and customer loyalty means that the bank customers will recommend their bank to other people. As a consequence, the banks can be assured of a loyal and stable customer base, thereby reducing the cost. Loyal customers increase their spending at an increasing rate, purchase services at full fare rather than at discount, and create operating efficiencies (Keaveney, 1995), leading to a higher market share and improved profitability (Brady & Cronin, 2001). Customer satisfaction is an important antecedent for loyalty and it has been found to be the most important determinant of loyalty among on-line bank customers (Yi, 1990).

By increasing loyalty, customer satisfaction secures future revenues; reduces the cost of future transactions, decreases price elasticity; and minimizes the likelihood customers would defect if quality falters (Reichheld & Sasser, 1990). Ranaweera and Prabhu (2003) found that customer satisfaction is a significant determinant of repeat sales, positive word of mouth, and customer loyalty. The result of literature study found the behavior was highly relevant after serving quality and customer purchasing. It is by and large believed that satisfaction leads to repeat purchase and positive word-of-mouth recommendation, which are the main indicators of loyalty. If consumers are satisfied with the product or service, they are more likely to carry on purchasing, and are more willing to spread positive word of mouth. Ravald and Gronroos (1996) found that that customer satisfaction is a better predictor of customer loyalty than service quality.

The third objective of this study sought to determine the relative effect of service quality and customer satisfaction on loyalty in the banking sector. Loyalty was the dependent variable while the other constructs were independent variables. The study expected that the two constructs of service quality and satisfaction jointly affect customer loyalty in commercial banking.

The following regression model was used to test the relationship between the independent and dependent variables:

$CL = \beta o + \beta 1SQ + \beta 2CS + e$

Where: $\beta o$ = Intercept or constant;

$\beta 1$ and $\beta 2$ = Regression coefficients or slope of the regression line of the independent variables 1 & 2. They indicate the relationship between the independent variables and the dependent variable

CL= Customer loyalty

SQ = Service quality

CS = customer satisfaction

$\varepsilon$ = Error or random term. It represents errors that could arise due to random behavior.

Regression coefficients were used to evaluate the strength of the relationship between the independent variables and the dependent variable. Beta coefficients of the independent variables were used to determine the relative importance to the dependent variable in the model. Therefore, regression coefficients were used to evaluate the strength of the relationship between the independent variables and the dependent variable. Chu (2002) claims that the beta coefficients of the independent variables can be used to determine its derived importance to the dependent variable compared with other independent variables in the same model. 0 is the constant, where the regression line intercepts the y axis and the error term represents the assumed random error will occur (Hair et al., 1998). The $R^2$ value in the model, provided a measure of the predictive ability of the model or measured the percentage of variance in the dependent variable explained collectively by all of the independent variables (Garson, 2008). The closer the value to 1, the better the regression equation fits the data. The F test was used to test the significance of the regression model as a whole.

The results of the regression model are shown in Table 4.9 below.

**Table 4.9: Regression Results for Service Quality and Customer Satisfaction**

| **Model Summary** | | | | |
|---|---|---|---|---|
| **Model** | **R** | **R Square** | **Adjusted R Square** | **Std. error of the estimate** |
| 1 | 0.84528[a] | 0. 7145 | 0.65 | 3.25692 |

| **Coefficients[b]** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Model** | | **Unstandardized coefficients** | | **Standardized coefficients** | | | **Collinearity Statistics** | |
| | | **B** | **Std. Error** | **Beta** | **T** | **Sig.** | **Tolerance** | **VIF** |
| 1 | Constant | 17.60 | 1.18 | | 14.92 | 0 | | |
| | SERVINDEX | 0.044 | 0.019 | 0.148 | 2.282 | 0.023 | 0.454 | 2.202 |
| | SATINDEX | 0.279 | 0.058 | 0.304 | 4.843 | 0 | 0.486 | 2.06 |

| **Model** | **Sum of squares** | **df** | **Mean Square** | **F** | **Sig** |
|---|---|---|---|---|---|
| Regression | 49.2661 | 1 | 14.5915 | 34.874 | 0.00[b] |
| Residual | 38.2442 | 299 | 0.4172 | | |
| Total | 87.5103 | 30 | | | |

In the results of the regression analysis, the standardized coefficients (β) of satisfaction and service quality show the relative importance of the two variables on customer loyalty. Satisfaction (β = 0.304) has the most influential effect on loyalty, followed by service quality (β = 0.148). It is evident from these results that satisfaction had the greatest effect on customer loyalty among the two constructs.

The results of the regression analysis as shown in Table 4.19 indicate that $R^2$ was 0.7145 or 71%. The statistical F test is used to determine how well the regression equation fits the data. In this study, the F value of 34.874 was significant at the 1% level, indicating that at least one of the independent variables helped to explain some of the variation in customer loyalty. Further, the adjusted coefficient of determination revealed that 65% of the variance in loyalty was explained by the regression model.

Thus, the $R^2$ in this regression model points to other factors not included in the model that account for loyalty in the bank. For instance, loyalty is affected by factors such as the bank's image, complaint management capabilities, the quality of communication between the firm and the customer, trust, demographic factors such as age, gender, ethnicity, and income and prior experience with the service industry in general (Parasuraman et al., 1991) which are beyond the scope of this study.

The test of correlations among the two variables reveals that there is a positive correlation between service quality and customer loyalty ($r = 0.445$, $p < 0.01$) and customer satisfaction and customer loyalty ($r = 0.84528$, $p < 0.05$). The value of the coefficients supported the multiple regression results. They show that customer satisfaction had the greatest influence on customer loyalty followed by service quality. The third objective of this study was to establish the relationship between customer satisfaction and loyalty in the banking sector in Kenya. Therefore, the results show that no one significant factor influences customer loyalty but rather a number of factors influence customer loyalty.

# CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.1 Introduction

This chapter presents the summary of findings, conclusions and recommendations derived from the results of the study. The study had three objectives to achieve: To determine the service quality levels of Commercial banks in Kenya; to establish the relationship between service quality and customer satisfaction in the banking sector and lastly, to establish the relationship between customer satisfaction and loyalty in the banking sector.

## 5.2 Summary of findings

The study established that there is a positive relationship among the three variables in the models under consideration, that is, service quality, customer satisfaction and customer loyalty. This finding was supported by Kumar et al. (2009) who stated that high quality of service will result in high customer satisfaction which in turn increases customer loyalty. Heskett et al. (1994) also argued that profitability and growth are stimulated primarily by customer loyalty and loyalty is a direct result of customer satisfaction.

The results from this study indicate that service quality and customer satisfaction jointly contributed to customer loyalty. Increase in customer loyalty implied greater positive word of mouth (Appiah- Adu, 1999), decreased price sensitivity and future transaction costs (Reichheld & Sasser, 1990) and, finally, leading to better business performance (Ryals, 2005; Choi et al., 2004). The positive relationship that was identified between service quality, customer satisfaction and customer loyalty may be interpreted as customer loyalty being increased as a result of experiencing a high quality of service when customers have high customer satisfaction.

The findings indicated that service quality has a direct effect on bank customer's loyalty. This implies that bank management should measure quality level of services offered and try to identify those areas that need improvement in order to gain and maintain a competitive advantage. Therefore, this study attempted to compare different methods that can help bank managers to decide upon those service quality aspects that need improvement. In this respect, efforts should be made for example to reduce the number of steps taken to apply for a loan and get approval and to increase the number of tellers in a branch where necessary. For instance, decreasing waiting time will affect customers' levels of satisfaction positively and doing things right the first time can help gain competitive advantage.

The findings indicated that customer satisfaction directly influenced the level of customer loyalty. The positive relationship identified between customer satisfaction and customer loyalty may be interpreted as satisfied customers having positive behavioral intentions to revisit or continue using the same bank after receiving high service quality that produces a good perceived value.  According to Brady et al. (2001), researchers and practitioners should identify ways of increasing customer satisfaction as a means of driving customer loyalty.  This means that satisfied customers are likely to engage in positive word-of-mouth and to continue engaging with the same bank which helps the bank reduce attrition and costs for acquiring new customers.

This link is very strong, and it shows that if the bank's management want to make their customers loyal, they should have some unique strategies to satisfy their customers. A satisfied customer will be less inclined to take the risk of moving to other competitors (Brady et al., 2001). Customer satisfaction is important to strategists because it is a significant determinant of recurring sales, positive word-of-mouth, intention to repurchase, and customer loyalty. This finding has been supported by Mouri (2005).

## 5.3 Conclusions

The research findings suggest that the inclination towards ease of banking and convenience is favored by the customer and therefore, banks should find alternative strategic routes designed to improve service delivery which can either be human-based or technology-based. Bank customers' attitudes towards the provision of services and subsequent levels of customer satisfaction will impact on bank customer loyalty.

Most bank products are not very differentiated and they can only distinguish themselves based on price and quality. Therefore, customer loyalty is an effective tool that banks can use to gain a strategic advantage and survive in today's competitive banking environment. The key factors affecting customer loyalty include the range of services, rates, fees and prices charged (Abratt & Russell, 1999).

## 5.4 Recommendations

Based on the study findings and their conclusions, a number of recommendations focusing on improving customer loyalty in commercial banks can be made. The study has the following managerial implications and recommendations.

Bank management should implement customer loyalty improvement programs in order to create and maintain long-lasting relationships with customers so as to have competitive advantage and to improve profitability. They should pursue customer loyalty as a marketing strategy which requires long-term commitment and understanding of service quality and satisfaction from the customer's perspective on the total bank experience. Bank management should adopt the loyalty multi- dimensional model consisting of the constructs of service quality and customer satisfaction. The study established that these have a joint positive effect on customer loyalty. Thus, the results of this study present a framework for thinking about banking service quality and its relationship to customer satisfaction and customer loyalty, which is valuable to managers seeking to create and maintain their competitiveness in the marketplace.

Loyal customers take less of the company's time during transactions and are less sensitive to price changes (Cohen et al., 2007). Companies with the highest number of loyal customers typically grow revenues at more than twice the rate of their competitors (Reichheld, 2006). Managers must therefore endeavor to maintain long term relationship with their customers.

An understanding of the relationships among the constructs studied in this model can be helpful to service managers seeking to provide quality service which influences the customer's overall satisfaction and ultimately loyalty. The results of this study indicate that service quality has an impact on customer loyalty through customer satisfaction. Thus, managers could use these findings to emphasize superior service quality which will lead to customer satisfaction and loyalty to their services.

Service quality is one of the critical success factors that influence the competitiveness of an organization. A bank can differentiate itself from competitors by providing high quality service. The findings showed that service quality dimensions can be used by banks to attract and maintain their customers. To survive in the competitive banking industry, banks have to develop new strategies which will satisfy their customers. Since it is impossible to have product differentiation in a competitive environment like the banking industry as all banks are delivering the same products, bank management should try to differentiate their firm from competitors through delivery of superior quality service. Today's customers have more choices for their financial needs than ever before. Service quality is an imperative factor impacting customers' satisfaction level in the banking industry.

Commercial bank managers need to invest in human capital. Employee training programs that provide employees with an understanding of service culture and service excellence should be emphasized when it comes to employee development. Employee training programs should focus on interpersonal communication and customer care areas in order to be able to meet the customers' need for personalized service. Employees using a professional approach during interactions with customers will be able to provide the service in an emphatic manner, promptly recover service failures if they are not able to provide service right the first time and ensure that the service delivered is consistent with the service promised. This will result in high customer satisfaction and retention (Reichheld & Teal, 1996; Caruana, 2002), within the Kenya Commercial Banking industry.

The findings indicate that while service quality is an important driver of customer loyalty, its indirect effect through customer satisfaction is overwhelmingly larger than the direct effect in generating higher customer loyalty. It is important for bank managers to understand the relevant service quality dimensions in banking that could build up positive customer satisfaction. Bank managers need to develop systematic assessment programs to monitor service quality and customer satisfaction over time. Bank staff should be informed of service results and be encouraged to take part in formulating and implementing an effective loyalty strategy.

The results of this study showed a strong link between customer satisfaction and loyalty which implies that if bank managers want to increase customer loyalty, they should formulate and implement some unique strategies to satisfy their customers. The managers should conduct customer surveys regularly and incorporate feedback in the changes desired by the customers.  The banks should invest in training programs for their employees in to make them more effective when serving customers, especially in handling customer complaints. This can help to improve customer satisfaction and retention by reducing attritions from dissatisfied customers.

The study found that customer satisfaction is not the sole determinant of customer loyalty in banking. This study shows that although there is a direct positive relationship between satisfaction and loyalty, other determinants play an important role too. Thus, bank managers should not only focus on customer satisfaction and overlook other important drivers of customer loyalty such as service quality.

Bank managers need to understand what customers' needs and how they assess service quality in order to achieve customer satisfaction. This study used a number of parameters to measure customer satisfaction which could provide several hints to bank managers in terms of how to deliver the desired levels of customer satisfaction. Customer loyalty can be achieved when customers' stated and unstated needs are fulfilled by the managers of the banks. The unstated needs can be the future needs of the customers. The point is, the managers should not only think of few basic needs of the customers. They should focus on providing extra pleasures to their customers.

Following the conclusion that service quality is a significant determinant of customer loyalty in the banking sector, the bank's management should organize training and continuous refresher courses for all bank employees whether customer facing or back office on modules intended to develop trustworthiness among bank employees as well in the bank to develop the character, positive attitude and good habits among the bank staff. Such modules must also dwell on the means and ways on improving efficiency in the bank. Although customer service has been evaluated many times before, it is still one study that banks must continue to conduct in order to meet the changes in the banking industry. New technologies and innovations must be incorporated as a factor to measure service quality in future researches. Researches and related questionnaires must also be accommodated with the new banking requirements of the customer. A clearer understanding as to the sequence of relationship between service quality, customer satisfaction and customer loyalty can help to ensure better targeting of customers using limited marketing resources.

This study has established that there is a link between service quality and customer satisfaction in creating customer loyalty in commercial banks. The interest in studying satisfaction and service quality as the antecedents of customer loyalty was stimulated by the recognition that customer satisfaction does not, on its own, produce customer loyalty (Appiah-Adu, 1999). Caruana et al. (2000) developed a mediational model that links service quality and customer loyalty via customer satisfaction and applied this model in retail banks.

The study has found that satisfaction and service quality are closely linked to customer loyalty. There are overwhelming arguments that it is more expensive to win new customers than to keep existing ones (Hormozi & Giles, 2004). This is in line with Athanassopoulos (2000) arguments that customer replacement costs, like advertising, promotion and sales expenses, are high and it takes time for new customers to become profitable or for the bank to even break even on the expenses incurred in acquiring the new customer.

## 5.5 Limitations of the Study

The researcher met respondents at the exits of the banking halls after they had carried out their transactions hence there is possibility of duplication of respondents.
The banks that were studied were branches based in Nairobi only. There might be differing results from other regions in the country given the different rate of development in the various counties in Kenya.

## 5.6 Suggestions for Further Research

The study takes note of the fact that data collection was done based on the views of the customers rather than on the actual data based on manipulation of variables. In actual sense, the study did not manipulate service quality, or service features and neither did it manipulate complaint handling procedures. As such the study cannot claim to have established the effect of these variables on customer loyalty as such a decision would require an experimental design. This study therefore recommends that an experimental study be conducted to determine the actual effect of these variables on customer loyalty among customers in the banking sector not only in Nairobi County, but in the banking sector as a whole. This study should form a basis for that study.

# APPENDICES

## APPENDIX I: REFERENCES


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## APPENDIX II: LIST OF COMMERCIAL BANKS

| RANK | BANK | % GROSS ASSETS |
|---|---|---|
| | 6 LARGE BANKS>5% | |
| 1 | Kenya Commercial Bank Ltd | 14.20% |
| 2 | Equity Bank Ltd | 8.60% |
| 3 | Co-operative Bank of Kenya Ltd | 8.50% |
| 4 | Barclays Bank of Kenya Ltd | 8.40% |
| 5 | Standard Chartered Bank Kenya Ltd | 7.90% |
| 6 | CFC Stanbic Bank Kenya Ltd | 6.70% |
| | | |
| | 14 MEDIUM BANKS (1-5)% | |
| 7 | Commercial Bank of Africa Ltd | 4.10% |
| 8 | I & M Bank Ltd | 3.80% |
| 9 | Diamond Trust Bank Kenya Ltd | 3.70% |
| 10 | NIC Bank Ltd | 3.60% |
| 11 | Citibank.N.A. Kenya | 3.50% |
| 12 | National Bank of Kenya Ltd | 3.50% |
| 13 | Chase Bank Ltd | 1.90% |
| 14 | Bank of Africa Kenya Ltd | 1.80% |
| 15 | Bank of Baroda Kenya Ltd | 1.80% |
| 16 | Prime Bank Ltd | 1.70% |
| 17 | Ecobank Kenya Ltd | 1.40% |
| 18 | Family Bank Ltd | 1.30% |
| 19 | Imperial Bank Ltd | 1.30% |
| 20 | Bank of India Ltd | 1.10% |
| | | |
| | 23 SMALL BANKS <1% | |
| 21 | Consolidated Bank of Kenya | 0.80% |
| 22 | Fina Bank Ltd | 0.70% |
| 23 | Gulf African Bank Ltd | 0.60% |
| 24 | African Banking Corporation Ltd | 0.60% |
| 25 | Equatorial Commercial Bank Ltd | 0.60% |
| 26 | Giro Commercial Bank Ltd | 0.60% |

| RANK | BANK | % GROSS ASSETS |
|---|---|---|
| 27 | Development Bank of Kenya Ltd | 0.60% |
| 28 | Fidelity Commercial Bank Ltd | 0.50% |
| 29 | K-Rep Bank Ltd | 0.50% |
| 30 | Guardian Bank Ltd | 0.50% |
| 31 | First Community Bank Ltd | 0.40% |
| 32 | Habib Bank A.G. Zurich | 0.40% |
| 33 | Transnational Bank Ltd | 0.40% |
| 34 | Victoria Commercial Bank Ltd | 0.40% |
| 35 | Charterhouse Bank Ltd | 0.30% |
| 36 | Habib Bank Ltd | 0.30% |
| 37 | Credit Bank Ltd | 0.30% |
| 38 | Paramount Universal Bank | 0.30% |
| 39 | Oriental Commercial Bank | 0.20% |
| 40 | Middle East Bank Kenya Ltd | 0.20% |
| 41 | UBA Kenya Ltd | 0.10% |
| 42 | Dubai Bank Ltd | 0.10% |
| 43 | Jamii Bora Bank Ltd | 0.10% |

**Source: CBK (2013)**

# APPENDIX III: QUESTIONNAIRE

Dear Sir/Madam,

I am a Master of business administration (MBA) student of the University of Nairobi. I am carrying out a research project to determine the relationship between service quality, customer satisfaction and loyalty among commercial banks in Kenya. As such, the study will be of use to the management of commercial banks and financial institutions in general.

You are kindly requested to answer all questions in this research questionnaire. The information that you will provide shall be treated with a high level of confidentiality and strictly used for the purpose of this research study.

**Instructions:** (*Please read the instructions given and answer the questions as appropriately as possible*). Make an attempt to answer every question fully and correctly.

**Section A: General Information**

1. Kindly indicate the name of your bank:……………………………………………
2. What is your age group? 18-25 years ☐ 26-35 years ☐

   36-54 years ☐ 46-55 years ☐

   Over 55 years ☐

3. Please tick your highest academic qualification

College certificate ☐

Bachelor’s Degree ☐

Master’s Degree ☐

Other (specify)……………………………………..

**Section B: Indicators of customer satisfaction**

3. The statements below are indicators of the determinants of customer satisfaction with banks' services. Please rank the following on a scale of 1-5(minimum to maximum) to reflect your feelings and the extent to which you agree with the statements.

| **Construct** | **Strongly Disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** |
|---|---|---|---|---|---|
| The employees are consistently courteous with customers | | | | | |
| The employees have adequate knowledge to answer customers' questions | | | | | |
| The staff are able to communicate clearly with customers | | | | | |
| The employees understand customers' specific needs | | | | | |
| The bank employees are always willing to help me | | | | | |
| The bank keenly listens to customers and take appropriate action making me feel valued | | | | | |
| When the bank promises a certain service by a certain time, it delivers | | | | | |
| The banks physical appearance is appealing | | | | | |
| The bank employees give me prompt service | | | | | |
| My bank always performs the service right the first time | | | | | |
| My bank always delivers excellent overall service | | | | | |
| The services offered by my bank are of high quality | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| My bank delivers superior service in every way | | | | | |
| Repeatedly, the performance of this bank is superior to that of competitors | | | | | |
| I feel very pleased with services offered by my bank | | | | | |
| The bank offers a good variety of products and services that suit my needs | | | | | |
| The bank's interest rates are satisfactory | | | | | |
| The bank charges for various products and services are satisfactory | | | | | |
| Advertisements and promotions are not at variance with the actual service experience | | | | | |
| My bank has operating hours and location convenient to all its customers | | | | | |
| I believe in my bank's credibility | | | | | |
| The employees instil confidence in customers | | | | | |

**Section B: Indicators of Customer Loyalty**

4. The statements below are indicators of the level of loyalty to your bank. Please rank the following on a scale 1-5(minimum to maximum) to reflect your feelings and the extent to which you agree with the statements.

| **Construct** | **Strongly Disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** |
|---|---|---|---|---|---|
| I believe my bank can satisfy my future needs | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| I will continue to patronize this bank even if the service charges are increased moderately | | | | | |
| I am likely to pay a little bit more for using the services of this bank | | | | | |
| I would like to remain as a customer of my present bank | | | | | |
| I would like to recommend my bank to friends and people I know | | | | | |
| I will say positive things about my bank to other people | | | | | |
| I would like to keep close relationship with my bank | | | | | |
| I consider myself to be loyal to my bank | | | | | |

6. Do you have more than one bank account? Yes [ ] No [ ]

7. If you answered yes in the above question, what is your reason for operating with more than one bank?

…………………………………………………………………………………………………

8. What do you think needs to be done to increase your level of satisfaction with the bank's service and products?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

**THANK YOU SO MUCH FOR YOUR TIME.**