

# The Influence of Sharia Compliance, Risk Perception and Service Quality on the Trust and Loyalty of Islamic Rural Bank Customers in Indonesia

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This study investigates the effect of Sharia compliance, risk perceptions, and service quality on the trust and loyalty of customers of the Islamic Rural Bank Customers. The sample consisted of 100 customers from four Islamic Rural Banks in Indonesia. The analysis was carried out with a factor based structural equation model. It was found that Sharia compliance, risk perception and service quality significantly influences customer trust and Sharia compliance and risk perception affects customer loyalty. Service quality has no significant effect on customer loyalty. These findings suggest that Sharia compliance with risk perception and service quality are important determinants of the trust and loyalty of Islamic Rural Bank customers.

**Key words:** *Sharia compliance, risk perception, service quality, trust, loyalty.*

## Introduction

As a country with a majority Muslim population, the financial crisis in the late 1990s gave rise to a new enthusiasm to elevate the Islamic-based banking system (Sharia). Many conventional banks in Indonesia establish subsidiaries that have Islamic characteristics. At the micro level, the Islamic Rural Bank (IRB) is also developing. The Islamic Rural Bank serves micro, small and middle economics in urban and rural areas. Development trends that occur continue to increase both in terms of assets, sources of funds, and financing provided (Hosen & Muhari, 2013).

Although there have been many theoretical studies on Sharia banking, there is still little research that seeks to examine the issue of Sharia banking from a customer perspective

(Pepinsky, 2010). Existing studies look more at the religious aspect of customers in determining customer loyalty in Islamic banking (Ayuni, Hussein & Handrito, 2015; Hidayat & Akhmad, 2015). There is no research that considers the compliance factor from the banking side itself regarding the application of Sharia principles (Hidayah, 2014).

This paper investigates the effect of Sharia compliance, risk perceptions and service quality factors in influencing the level of customer loyalty and the mediating role of customer trust in the Islamic Rural Bank. The main argument that underlies this investigation is that Sharia compliance is actually a kind of "religiosity" from the banking side itself. We believe that banking with Sharia compliance should play a role in the rational consideration of customers to trust the bank and be loyal to it. Failure of banks to apply Sharia principles will result in customers losing trust and turning to more compliant banking.

This research provides a number of important contributions. First, this study will illustrate customer perceptions of banking compliance that claim to be based on Sharia, over Sharia principles that allow an assessment of the degree of Sharia of a number of banks at the micro level. Second, this research will determine whether compliance with Sharia principles is a variable that customers take into account in trusting and being loyal to a Sharia-based bank. If customers apparently do not consider this, then it can be predicted that in the future Islamic banking regulations must be strengthened to prevent the presence of banks that merely use the Islamic label to attract customers.

## **Literature Review**

The literature review is directed at examining the concepts of: customer loyalty; customer trust; compliance with the implementation of the Sharia system; risk perception; and service quality. We review the interrelations between these concepts in the context of Islamic banking. This will then be the basis for developing hypotheses which will then be tested in the Islamic Rural Bank context.

### ***Customer Loyalty***

Customer loyalty in general is a repeat purchase of a product or service. This concept then develops to include not only the actions of customers on products or services, but also on the behaviour of customers to recommend service providers to others (de Ruyter, Wetzels, & Bloemer, 1998). In the banking context, loyalty is interpreted as a continuous patronisation of customers in a bank continuously (Amin, Isa & Fontaine, 2013).

### ***Customer Trust***

Trust is the expectation of positive outcomes that can be obtained based on the actions expected from other parties (Thomas & Kozhikode, 2009). The concept of belief in Islamic teachings is quite central, recorded in the Qur'an 4:58 and 2:283 (Mohamed, Nizam, Badaruddin, & Choong, 2011). Trust becomes even more important in the context of Islamic banking because of some aspects; there is an unclear material difference between Islamic banking and conventional banking (Tahir, 2007). However, Nawaz (2013) shows that the nature of customer trust in Pakistan in Islamic banking is blind, in the sense of having a high tendency to trust, but having a low ability to analyse risk. In spite of that, this seems to be contextual, because (Mansour, Hajlaoui, Abdulkarim, & Nassief, 2016) find that in Middle Eastern countries, Islamic banks actually experience a kind of crisis of confidence from customers.

The theory of trust-commitment states that trust adds value to the transactional relationships that occur. This added value makes customers more likely to make transactions. This in turn leads to increased customer loyalty (Chaudhuri & Holbrook, 2001). This relationship is confirmed by research in conventional banking (Hasan, Kiong, & Ainuddin, 2014) and Islamic banking (Hoq, Sultana, & Amin, 2010). However, the results on Islamic banking appear to be less consistent because Kishada & Wahab (2015) found no relationship between trust and loyalty in studies in Malaysia.

### ***Sharia Compliance***

Research on the concept of compliance generally shows a relationship between compliance and the level of customer confidence. Yousafzai, Pallister, & Foxall (2005) research found that bank compliance statements on banking rules affect the level of customer confidence. Theoretically, the relationship between adherence to a standard, subjective or objective, allows one to feel confident about the future behaviour of a partner. This in turn gives legitimacy to the organisation and guarantees customers trust the organisation (Yousafzai et al., 2005). The existence of bank compliance with a standard reflects a careful and explicit policy to protect customer funds and sensitive customer information (Salam, Iyer, Palvia, & Singh, 2005). This should result in added value to the transactional relationship between banks and customers. The theory of commitment states that the added value in a relationship is the basis of loyalty.

### ***Risk Perceptions***

Risk perceptions are beliefs, judgments, feelings, inclinations, attitudes, feelings and social values regarding the risk attributes of something (Pidgeon, Hood, & Jones, 1992). The things

that compile the concept of risk perception are subjective assessments, not actual risks (Bazyar, Teimoury, Fesharaki, Moini, & Mohammadi, 2013). In the context of banking customers, risk perception means subjective perception or assessment of the negative consequences of the decision to become a banking customer. The relationship between risk perception and trust in the literature has differing opinions about whether risk is an antecedent for trust or vice versa, or both are independent variables. In general, studies assess that trust is the antecedent of risk perception (Malaquias & Hwang, 2016, Roy, Balaji, Kesharwani, & Sekhon, 2017; Mahesh & Dasanayaka, 2016). Kim, Ferrin, & Rao (2008) and Nicolaou & Mcknight (2006) see that trust gives a negative effect on risk perception. The reason is that trust gives a person some confidence so that they feel the risk is decreasing. On the other hand, those who think that risk perception is an antecedent of trust argues that someone perceives others as capable, good and having integrity, so that person can be trusted (Kim et al, 2008). This means, if risk perception is low, then confidence will be high. According to KK Kim & Prabhakar (2000) risk perception can affect trust because the act of trust is an act that takes risks, carried out by weighing the profit and loss of an act of trust. This is in line with the opinion of Delgado-Ballester & Luis Munuera-Alemán (2001) that risk perception is a condition for the emergence of trust. The approach that uses trust as a consequent risk is used in banking research by Kim and Prabhakar (2000).

Cognitive locking theory argues that a person will choose a service provider who is better known for reducing risk perception, which in turn will increase loyalty (Casaló, Flavián, & Guinalíu, 2008). Previous research also showed a significant relationship between risk perception and customer loyalty (Jin, Line, & Merkebu, 2015).

### ***Service Quality***

Service quality is generally defined as how well the service is provided in accordance with customer expectations (Parasuraman, Zeithaml, & Berry, 1985). Research shows that service quality has a positive effect on trust (Kassim & Asiah Abdullah, 2010; Park, Lee, Lee, & Truex, 2012; Ribbink, van Riel, Liljander, & Streukens, 2004). The reason is because the quality of service is an indication that something can be trusted (Ribbink et al., 2004). Studies in general have agreed that service quality influences customer loyalty (Akbar & Parvez, 2009; Kassim & Asiah Abdullah, 2010). This is because service quality increases satisfaction and satisfied customers will be loyal to service providers (Kassim and Abdullah, 2010).

## Data Analysis

### *Evaluation of Measurement Models*

At this stage an evaluation of the measurement model is carried out through confirmatory factor analysis (CFA) by testing the construct validity and reliability. Construct validity is tested by looking at the estimated output and comparing the p-value at the estimated output with an alpha of 5%. If the p-value is less than 5%, then the indicator is declared valid. While the reliability test is done by looking at the value of CR and VE in each construct. If the value of CR  $\geq 0.7$  and AVE  $\geq 0.5$  it means the construct is reliable. The following is a breakdown of the validity and reliability test results for each construct.

**Table 1:** Test CFA X1 (Sharia Compliance).

| CFA                    | Indicator | $\Lambda$ | $\lambda^2$ | e     | CR    | VE    |
|------------------------|-----------|-----------|-------------|-------|-------|-------|
| X1 (Sharia Compliance) | X1.1      | 0.763     | 0.582       | 0.418 | 0.958 | 0.590 |
|                        | X1.2      | 0.8950    | 0.801       | 0.199 |       |       |
|                        | X1.3      | 0.700     | 0.490       | 0.510 |       |       |
|                        | X1.4      | 0.795     | 0.632       | 0.368 |       |       |
|                        | X1.5      | 0.742     | 0.551       | 0.449 |       |       |
|                        | X1.6      | 0.748     | 0.560       | 0.440 |       |       |
|                        | X1.7      | 0.651     | 0.424       | 0.576 |       |       |
|                        | X1.8      | 0.850     | 0.732       | 0.278 |       |       |
|                        | X1.9      | 0.760     | 0.578       | 0.422 |       |       |
|                        | X1.10     | 0.742     | 0.551       | 0.449 |       |       |
|                        | X1.11     | 0.747     | 0.558       | 0.442 |       |       |
|                        | X1.12     | 0.755     | 0.570       | 0.430 |       |       |
|                        | X1.13     | 0.706     | 0.498       | 0.502 |       |       |
|                        | X1.14     | 0.905     | 0.819       | 0.181 |       |       |
|                        | X1.15     | 0.709     | 0.503       | 0.497 |       |       |
|                        | X1.16     | 0.778     | 0.605       | 0.395 |       |       |

Based Table 1, each indicator in CFA X1 (Sharia Compliance) has a standardised loading estimate value greater than 0.5, so it is concluded that each indicator in CFA X1 is valid. The CR value obtained is greater than 0.7 and the VE value obtained is greater than 0.5 which indicates that CFA X1 is reliable.

**Table 2:** Test CFA X2 (Risk Perception).

| CFA                  | Indicator | $\lambda$ | $\lambda^2$ | e     | CR    | VE    |
|----------------------|-----------|-----------|-------------|-------|-------|-------|
| X2 (Risk Perception) | X2.1      | 0.902     | 0.814       | 0.186 | 0.953 | 0.653 |
|                      | X2.2      | 0.855     | 0.731       | 0.269 |       |       |
|                      | X2.3      | 0.733     | 0.537       | 0.463 |       |       |
|                      | X2.4      | 0.656     | 0.430       | 0.570 |       |       |
|                      | X2.5      | 0.867     | 0.752       | 0.248 |       |       |
|                      | X2.6      | 0.828     | 0.686       | 0.314 |       |       |
|                      | X2.7      | 0.706     | 0.498       | 0.502 |       |       |
|                      | X2.8      | 0.673     | 0.453       | 0.547 |       |       |
|                      | X2.9      | 0.708     | 0.501       | 0.499 |       |       |
|                      | X2.10     | 0.943     | 0.889       | 0.111 |       |       |
|                      | X2.11     | 0.943     | 0.889       | 0.111 |       |       |

Based on Table 2, each indicator in CFA X2 (Risk Perception) has a standardised loading estimate value greater than 0.5 so that it is concluded that each indicator in CFA X2 is valid. The CR value obtained is greater than 0.7 and the VE value obtained is greater than 0.5 which indicates that CFA X2 is reliable.

**Table 3:** Test CFA X3 (Kualitas Pelayanan).

| CFA                     | Indicator | $\lambda$ | $\lambda^2$ | e     | CR    | VE    |
|-------------------------|-----------|-----------|-------------|-------|-------|-------|
| X3 (Quality of Service) | X3.1      | 0.783     | 0.613       | 0.387 | 0.984 | 0.686 |
|                         | X3.2      | 0.810     | 0.656       | 0.344 |       |       |
|                         | X3.3      | 0.922     | 0.850       | 0.150 |       |       |
|                         | X3.4      | 0.914     | 0.835       | 0.165 |       |       |
|                         | X3.5      | 0.854     | 0.729       | 0.271 |       |       |
|                         | X3.6      | 0.886     | 0.785       | 0.215 |       |       |
|                         | X3.7      | 0.909     | 0.826       | 0.174 |       |       |
|                         | X3.8      | 0.899     | 0.808       | 0.192 |       |       |
|                         | X3.9      | 0.826     | 0.682       | 0.318 |       |       |
|                         | X3.10     | 0.825     | 0.681       | 0.319 |       |       |
|                         | X3.11     | 0.840     | 0.706       | 0.294 |       |       |
|                         | X3.12     | 0.874     | 0.764       | 0.236 |       |       |
|                         | X3.13     | 0.907     | 0.823       | 0.177 |       |       |
|                         | X3.14     | 0.701     | 0.491       | 0.509 |       |       |
|                         | X3.15     | 0.921     | 0.848       | 0.152 |       |       |
|                         | X3.16     | 0.948     | 0.899       | 0.101 |       |       |
|                         | X3.17     | 0.821     | 0.674       | 0.326 |       |       |
|                         | X3.18     | 0.757     | 0.573       | 0.427 |       |       |
|                         | X3.19     | 0.705     | 0.497       | 0.503 |       |       |
|                         | X3.20     | 0.710     | 0.504       | 0.496 |       |       |
|                         | X3.21     | 0.699     | 0.448       | 0.552 |       |       |
|                         | X3.22     | 0.703     | 0.494       | 0.506 |       |       |
|                         | X3.23     | 0.875     | 0.766       | 0.234 |       |       |
|                         | X3.24     | 0.682     | 0.465       | 0.535 |       |       |
|                         | X3.25     | 0.906     | 0.821       | 0.179 |       |       |
|                         | X3.26     | 0.829     | 0.687       | 0.313 |       |       |
|                         | X3.27     | 0.696     | 0.484       | 0.516 |       |       |
|                         | X3.28     | 0.849     | 0.721       | 0.279 |       |       |
|                         | X3.29     | 0.880     | 0.774       | 0.226 |       |       |

Based Table 3, each indicator in CFA X3 (Service Quality) has a standardised loading estimate value greater than 0.5 so that it is concluded that each indicator in CFA X3 is valid. The CR value obtained is greater than 0.7 and the VE value obtained is greater than 0.5 indicating that CFA X3 is reliable.

**Table 4:** Test CFA X4 (Customer of Trust).

| CFA                    | Indicator | $\lambda$ | $\lambda^2$ | e     | CR    | VE    |
|------------------------|-----------|-----------|-------------|-------|-------|-------|
| X4 (Customer of Trust) | X4.1      | 0.758     | 0.575       | 0.425 | 0.963 | 0.687 |
|                        | X4.2      | 0.965     | 0.931       | 0.069 |       |       |
|                        | X4.3      | 0.652     | 0.425       | 0.575 |       |       |
|                        | X4.4      | 0.719     | 0.517       | 0.483 |       |       |
|                        | X4.5      | 0.980     | 0.960       | 0.040 |       |       |
|                        | X4.6      | 0.813     | 0.661       | 0.339 |       |       |
|                        | X4.7      | 0.692     | 0.479       | 0.521 |       |       |
|                        | X4.8      | 0.908     | 0.824       | 0.176 |       |       |
|                        | X4.9      | 0.927     | 0.859       | 0.141 |       |       |
|                        | X4.10     | 0.976     | 0.953       | 0.047 |       |       |
|                        | X4.11     | 0.717     | 0.514       | 0.486 |       |       |
|                        | X4.12     | 0.742     | 0.551       | 0.449 |       |       |

Based Table 4, each indicator in CFA X4 (Customer Trust) has a standardised loading estimate value greater than 0.5 so that it is concluded that each indicator in CFA X4 is valid. The CR value obtained is greater than 0.7 and the VE value obtained is greater than 0.5 indicating that CFA X4 is reliable.

**Table 5:** Test CFA X5 (Customer Loyalty).

| CFA                   | Indicator | $\lambda$ | $\lambda^2$ | e     | CR    | VE    |
|-----------------------|-----------|-----------|-------------|-------|-------|-------|
| X5 (Customer Loyalty) | X5.1      | 0.733     | 0.537       | 0.463 | 0.959 | 0.627 |
|                       | X5.2      | 0.694     | 0.482       | 0.518 |       |       |
|                       | X5.3      | 0.733     | 0.537       | 0.463 |       |       |
|                       | X5.4      | 0.710     | 0.504       | 0.496 |       |       |
|                       | X5.5      | 0.692     | 0.479       | 0.521 |       |       |
|                       | X5.6      | 0.962     | 0.925       | 0.075 |       |       |
|                       | X5.7      | 0.970     | 0.941       | 0.059 |       |       |
|                       | X5.8      | 0.880     | 0.774       | 0.226 |       |       |
|                       | X5.9      | 0.913     | 0.834       | 0.166 |       |       |
|                       | X5.10     | 0.757     | 0.573       | 0.427 |       |       |
|                       | X5.11     | 0.685     | 0.469       | 0.531 |       |       |
|                       | X5.12     | 0.786     | 0.618       | 0.382 |       |       |
|                       | X5.13     | 0.709     | 0.503       | 0.497 |       |       |
|                       | X5.14     | 0.772     | 0.596       | 0.404 |       |       |

Based Table 5, each indicator in CFA X5 (Customer Loyalty) has a standardised loading estimate value greater than 0.5, so it is concluded that each indicator in CFA X5 is valid. The



CR value obtained is greater than 0.7 and the VE value obtained is greater than 0.5 which indicates that CFA X5 is reliable.

### ***Data Analysis***

#### ***Regression Analysis***

The equation based on the above model, is as follows:

Trust (T) = 0.062 \* Risk Perception (RP) + 0.225 \* (Service Quality/SQ) - 0.069 \* (Sharia Compliance/SC) Errorvar = 0.941, R-square = 0.059

Customer Loyalty (CL) = 0.307 \* (Sharia Compliance/SC) + 0.412 \* Trust + 0.321 \* (Service Quality/SQ) + 0.216 \* (Risk Perception/RP) Errorvar = 0.534, R-square = 0.466

Based on this equation, the following conclusions were made.

#### ***First Equation***

- a. The regression coefficient of the variable Risk Perception (RP) is 0.062 with a positive direction meaning that there is a direct relationship that is if the RP increases by 1 unit then the trust (T) will increase by 0.062.
- b. Service Quality (SQ) variable regression coefficient is 0.225 with a positive direction means that there is a direct relationship that is if the SQ increases by 1 unit then the T will increase by 0.225.
- c. The regression coefficient for the variable Sharia Compliance (SC) is -0.069 with a negative direction meaning that there is a non-directional relationship i.e. if SC increases by 1 unit the T will decrease by 0.069.
- d. The R-square value obtained is 0.059. This means that the RP, SQ, and SC variables have an effect of 5.9% on T, while an error of 0.941 indicates that T is influenced by other factors not examined in this study, amounting to 94.1%.

#### ***Second Equation***

- a. The regression coefficient of the variable Sharia Compliance (SC) is 0.307 with a positive direction meaning that there is a direct relationship that is if SC increases by 1 unit the Customer Loyalty (CL) will increase by 0.307.
- b. The regression coefficient of the T variable is 0.412 with a positive direction meaning that there is a direct relationship i.e. if T increases by 1 unit the CL will increase by 0.412.
- c. Service Quality (SQ) variable regression coefficient is 0.321 with a positive direction means that there is a direct relationship that is if SQ increases by 1 unit then CL will increase by 0.321.

- d. The regression coefficient of the variable Risk Perception (RP) is 0.216 with a positive direction meaning that there is a direct relationship i.e. if RP increases by 1 unit then CL will increase by 0.216.
- e. The R-square value obtained is 0.466. This means that the variables Sharia Compliance (SC), Trust (T), Service Quality (SQ) and Risk Perception (RP) provide an influence of 46.6% on Customer Loyalty (CL) while an error of 0.534 indicates that CL is influenced by other factors not examined in this study, amounting to 53.4%.

### ***Partial Hypothesis Testing Results***

Based on the above model, it can be seen that the relationship between the independent variables and the dependent variable is as follows.

**Table 6:** Summary of partial Hypothesis Testing.

|         |      |       | Estimate | S.E.  | C.R.   | P     |
|---------|------|-------|----------|-------|--------|-------|
| Loyalty | <--- | SC    | 0.316    | 0.086 | 3.658  | ***   |
| Loyalty | <--- | RP    | 0.149    | 0.055 | 2.701  | 0.007 |
| Loyalty | <--- | SQ    | 0.386    | 0.103 | 3.759  | ***   |
| Trust   | <--- | SC    | -0.076   | 0.110 | -0.690 | 0.490 |
| Trust   | <--- | RP    | 0.045    | 0.073 | 0.624  | 0.533 |
| Trust   | <--- | SQ    | 0.288    | 0.131 | 2.203  | 0.028 |
| Loyalty | <--- | Trust | 0.388    | 0.086 | 4.518  | ***   |
|         |      |       |          |       |        |       |

An asterisk (\*\*\*) indicates a value lower than 0.0001.

The general hypothesis used is as follows:

**Ho:** The independent variable has no significant effect on the dependent variable.

**Ha:** The independent variable has a significant effect on the dependent variable.

The basis for decision making for this test is as follows:

If  $P < 0.05$  at the level  $\alpha$  5%, then  $H_0$  is rejected.

If  $P > 0.05$  at the level  $\alpha$  5%, then  $H_0$  is accepted.

Based on Table 6, it can be concluded as follows:

- a. The Sharia Compliance (SC) variable has a p-value lower than 0.0001 (\*\*\*). Because the p-value is lower than 0.05,  $H_{1a}$  is accepted, meaning that SC has a significant effect on Customer Loyalty (CL).

- b. The Risk Perception (RP) variable has a p-value of 0.007. Because the p-value is lower than 0.05 then H1b is accepted, meaning that RP has a significant effect on CL.
- c. The Service Quality (SQ) variable has a p-value lower than 0.0001 (\*\*\*). Because the p-value is lower than 0.05 then H1c is accepted, meaning that SQ has a significant effect on CL.
- d. The Sharia Compliance (SC) variable has a p-value of 0.490. Because the p-value is greater than 0.05 then H1d is rejected, meaning that SC has no significant effect on Trust (T).
- e. The Risk Perception (RP) variable has a p-value of 0.533. Because the p-value is greater than 0.05 then H1e is rejected, meaning that the RP does not have a significant effect on the T.
- f. The Service Quality (SQ) variable has a p-value of 0.028. Because the p-value is lower than 0.05 then H1f is accepted, meaning that SQ has a significant influence on T.
- g. The T variable has a p-value lower than 0.0001 (\*\*\*). Because the p-value is lower than 0.05 then H1g is accepted, meaning that T has a significant effect on CL.

### **Conclusions on Research Issues**

Based on the analysis that has been conducted, the research findings obtained were as follows: Sharia compliance, risk perception and service quality have a significant effect on customer trust. Customer trust has a significant effect on customer loyalty. Sharia compliance and risk perception have a significant effect on customer loyalty. Service quality has no significant effect on customer loyalty. Sharia Compliance has a significant direct or indirect effect on customer trust in customer loyalty. Risk perception has a direct significant effect on customer loyalty and also has a direct effect on customer loyalty through customer trust. Service quality has an indirect effect through customer trust to customer loyalty.

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