

## Measuring the Relationship between Service Quality, Customer Satisfaction and Customer Loyalty in the Banking Sector of Nepal<sup>1</sup>

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### Abstract

This study aims to examine the mediating effect of customer satisfaction in the relationship between service quality and customer loyalty in the banking sector of Nepal. Tangibility was taken as hard aspect and two dimensions; responsiveness and assurance were taken as soft aspects of service quality to measure customer satisfaction and loyalty. 384 customers of three commercial banks operating in Kailali district i.e. Rastriya Banijya Bank, Nabil Bank and Global IME bank were surveyed using structured five-point Likert scale questionnaire. Data was collected via online and field survey using convenience sampling method. The research hypotheses were tested using Structural equation modeling (SEM) with the help of AMOS-22 software. The findings of this study revealed that there is significant positive relationship between service quality, customer satisfaction and loyalty. It means higher the service quality helps to increase customer satisfaction and loyalty. Customer satisfaction has partial mediation effect in the relationship between service quality and customer loyalty. The results of this study will help bank managers to focus on their customer's satisfaction and loyalty in order to develop the strategy for competitive advantages. Future researchers can conduct their study on serial and parallel mediation effect of customer satisfaction in service quality and customer loyalty.

**Keywords:** Customer loyalty, Customer satisfaction, Service quality, Structural equation modeling (SEM).

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## Introduction

In most developing countries like Nepal, the banking industry is in growing stage and playing a vital role in economic growth and prosperity. Bank and financial institution is important tool for economic development and continuously expanding their contribution in a wide range of financial services as well as investment opportunities to economic growth (Ostrom & Bitner, 2010). As a service industry, bank should provide better services to its customers. Service quality is important for customer satisfaction and loyalty (Khalid & Irshad, 2010). Customers have more awareness on required standards of quality. Service providers should also aware about good relationship with their customers that define customer satisfaction and loyalty with the organization (Joseph, Sekhon, & Stone, 2005). Service quality is necessary to achieve institutional goals effectively and efficiently. In the present era of cut-throat competition, organizations are required to improve their performance through quality improvement and delivery (Bharwana, Bashir, & Mohsin, 2013). Customer satisfaction and loyalty is considered vitally important for any customer-oriented service organization as it leads to profit. From the marketing point of view, studies state that establishing customer loyalty contributes to the growth as well cost control of the firm. A study stated that retaining a customer costs five times less than attracting a new customer (Reichheld, 1993). Another study on customer loyalty specified that retention of customers and loyalty of customers could be obtained by improving service quality and customer satisfaction. Service quality is a determinant of customer satisfaction, hence it is considered as an essential factor for creating customer loyalty. Therefore, service quality is measured really important not only for the firms' success but also for their continued existence (Chen, Gupta, & Rom, 1994).

In today's globalization and digitalization stage, the Nepalese banking sector is growing at a rapid pace. Economic liberalization enhances the establishment of private as well as joint venture banks in Nepal. According to Nepal Rashtra Bank (2023), there are 20 commercial banks serving in Nepal. Physical infrastructure, service procedure and manpower are major factors to provide services in banking sector. Nepalese banking service quality and customer satisfaction has positive and significant association (Gyawali & Kunwar, 2014). Furthermore customer satisfaction is highly affected by service quality in the commercial banks of Nepal (Koirala & Shrestha, 2012). Customer satisfaction leads to customer retention/loyalty (Kotler & Keller, 2012). In the present

scenario, markets rely on customer satisfaction and customer loyalty, which depends on service quality offered. In this context, here arises a research issue; does customer satisfaction mediate among the service quality and customer loyalty in Nepalese banking sector? This research is carried out to analyze the relationship between banking service quality, customer satisfaction and customer loyalty in Nepal. Furthermore this study aims to examine the mediating effect of customer satisfaction between service quality and customer loyalty.

## **Literature Review**

### **Service quality**

The foundation of defining and measuring service quality was established by Gronroos (1984) and Parasuraman et al. (1988). Gronroos, (1984) has suggested that the quality of service as perceived by the customer has two dimensions i.e., technical or outcome dimension and the function of process related dimensions. Parasuraman et al., (1988) have defined service quality as the delivery of excellent or superior service relative to customer expectation. They argued that the customer's perception of service quality offering is a function of ten dimensions categorized as access, communication, competence, credibility, courtesy, reliability, responsiveness, security, tangibles and understanding/knowing customers. Kotler and Armstrong, (2006) have defined the term service quality as the ability of a service firm to hang on to its customer. Furthermore, in their opinion customer retention is the best measure of service quality. Service quality is a measure of how well the service level delivered matches customer expectations. Delivering quality service means conforming to customer expectations on a consistent basis (Lewis, 1991). Service quality can be defined as the difference between customer expectations of service and service perception. If expectations are greater than performance, then perceived quality is less satisfactory or customer dissatisfaction occurs, if the performance is greater than expectation then customer satisfaction occurs (Bhatta & Durgapal, 2016). According to the SERVQUAL model by Parasuraman, et al., (1988), service quality can be measured by identifying the gaps between customers' expectations of the service to be rendered and their perceptions of the actual performance of the service. SERVQUAL is based on five dimensions of service quality (Parasuraman, Berry, & Zeithaml, 1988). Tangibles: the physical surroundings represented by objects i.e., interior design and the appearance of employees. Reliability: the service provider's ability to provide accurate and reliable services. Responsiveness: a

firm's willingness to assist its customers by providing fast and efficient service performances. Assurance: knowledge and politeness of employees and their ability to inspire trust and confidence. Empathy: Caring and individualized attention that the firm provides to its customers. Cronin and Taylor, (1992) have studied on measuring service quality: a reexamination and extension. In their empirical work propounded a performance-based measure of service quality called 'SERVPERF' illustrating that service quality was a form of consumer attitude. They argued that SERVPERF was an enhanced means of measuring the service quality construct. The SERVPERF model has same five dimensions as SERVQUAL model to measure the performance of service quality for customer satisfaction but it has focused in measures service quality by using the perceptions of customers. In this study, the SERVPERF scale is used to measure to service quality in banking Industry. Many studies have been conducted by adopting the SERVPERF model as better and effective model to measure the performance of service quality for customer satisfaction (Cronin & Taylor, 1992; Gyawali & Kunwar, 2014).

### **Customer satisfaction**

Customer satisfaction is a feeling of pleasure or disappointment customer after comparing the performance of the product results obtained with the expected performance. If performance is less than expectations, the customer becomes dissatisfied. If the performance meets expectations, then the customer becomes satisfied (Bhatta & Durgapal, 2016). The confirmation or disconfirmation of pre-consumption expectations is the essential determinant of satisfaction (Cronin & Taylor, 1992). Customer satisfaction is defined as "the individual's perception of the performance of the products or services in relation to his or her expectations" (Schiffman & Kanuk, 2004, p. 14). Satisfaction can also be a person's feelings of pleasure or disappointment that results from comparing a product's perceived performance or outcome with their expectations (Kotler & Keller, 2012). Customer satisfaction with a product or service is actually something that is difficult to obtain if the service company or industry does not really understand what customers expect. Therefore, a company must always pay attention to the quality of products and services provided to customers (Anderson & Sullivan, 1993). Many researchers have observed that satisfaction is a sense of feeling which comes from a procedure of interpreting and judging what is received as a result of expectation as an inclusion of wishes and requirements coupled with the purchase and purchase choice (Bharwana, Bashir, & Mohsin, 2013).

### **Customer loyalty**

Customer loyalty is the attachment of a customer with a brand (Aaker, 1991). Customer loyalty is a concept that has enjoyed extensive earning and usage within the field of consumer behavior for many years (Siddiqi, 2011; Mosahab, Mahamad, & Ramayah, 2010). Loyalty is a behavioral intent of buyers to keep relationships with service providers and willingness to use the company's products and services frequently over a long period of time and recommend the company's products and services to the neighboring setting (Tee, Preko, & Tee, 2018). Customer loyalty is a key element of the organization for its success. Company's profitability is influenced by the customer loyalty. Loyal customers are more attractive to companies because they tend to be fewer prices sensitivity and have a propensity to repeat purchase the company's products (File & Prince, 1992). Customer loyalty is customer belief in a product or service provided by the company resulting on positive attitude and repeat purchasing behavior (Reichheld, 1993). Customer loyalty is also customer behavior related to product or service attitudes, customers will have beliefs like or dislike and decide to repurchase a product or service (Siddiqi, 2011).

### **Service quality, customer satisfaction and customer loyalty**

Customer satisfaction and loyalty is becoming the vital objective of business firms which looking for long-term relationship with customer. Customer satisfaction plays a major role in customer loyalty. Therefore, the business firms should focus on enhancing customer perceptions of service quality and satisfaction (Hua, Kandampully, & Juwaheer, 2009). In the context of banking sector, customer relationship is one of the vital business processes and customer satisfaction is becoming the key for success. Furthermore, the main element determining customer satisfaction is the customer's perception of service quality (Koirala & Shrestha, 2012; Gyawali & Kunwar, 2014; Lamichhane, 2018). Customer satisfaction is described as the result of a comparison of the customers' expectations and his or her subsequent perceived performance of service quality (Bhatta & Durgapal, 2016). Strong positive linkages have been apparent between service quality and customer satisfaction (Anderson & Sullivan, 1993). Customer satisfaction is widely recognized as a key influencing factor in the formation of consumers' future purchase intentions (Taylor & Baker, 1994). High service quality and customer satisfaction often result in more repeat purchases and market share improvements (Buzzell & Gale, 1997). Customer satisfaction can play role of mediator

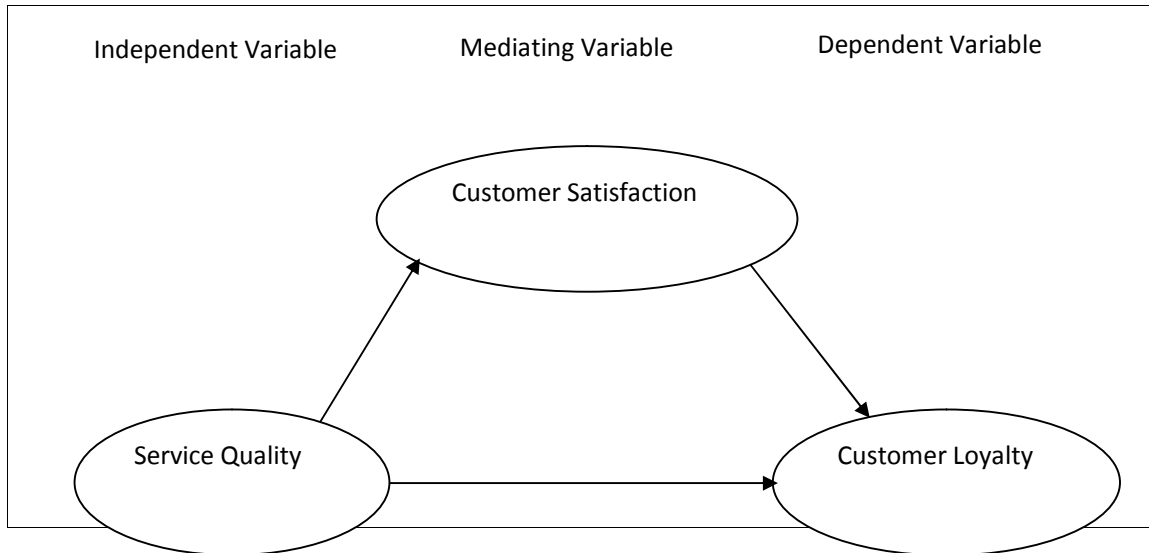
that fill the gap between service quality and customer loyalty. Service quality has positively related to customer satisfactions in banking sector (Siddiqi, 2011). This means customers have a certain predicted product performance in mind prior to consumption. During consumption, customers understand the product or service performance/quality (Kotler & Keller, 2012). There was positive and significant relationship between customers' satisfaction and banking service quality in Nepalese commercial banks (Gyawali & Kunwar, 2014; Pradhan & Shrestha, 2017). Service quality and customer satisfaction have been emphasized by the banking sector all over the world including Nepal. A study in Tanzania found that service quality has significant positive impact on customers' satisfaction in Tanzania Islamic banks. In addition, customer satisfaction mediates between the relationship of service quality and customer loyalty (Khamis & Rashid, 2018).

### **Research Framework**

Previous studies on service quality, customer satisfaction and customer loyalty showed these three variables have close relation. In order to establish a long-term relationship, the switching intention of the customers should be low which depends on the satisfaction level of the customers with their service provider in terms of service quality (Hua, Kandampully, & Juwaheer, 2009). Customer's perception of service quality is one of the major determinants of customer satisfaction (Cronin & Taylor, 1992). Studies have established that high level of service quality leads to high level of customer satisfaction. In addition to it, studies have established that there exists relationship between service quality and customer loyalty mediated by customer satisfaction through an indirect effect (Rajeswari, Srinivasulu, & Thiyagarajan, 2017; Gautam & Sah, 2023). According to previous studies, there are several factors which influence customer loyalty among which customer satisfaction is known as a principal factor. The intention of measuring customer satisfaction is measurement of customer loyalty because high customer satisfaction leads to high customer loyalty (Fornell, 1992). If the organization is able to satisfy the wants of the customers, then it is easier for them to establish customer loyalty (Oliver, 1999). With these references, this study aims to analyze the relationship among the three major factors of Nepalese banking industry. The research framework for this study relating the study variables is presented in Figure 1.

**Figure 1**

*Research framework describing the relationship between service quality, customer satisfaction and customer loyalty.*



### Research Hypothesis

Empirical evidence on the relationship between service quality, customer satisfaction and customer loyalty indicate that there is a positive significant relationship between service quality and customer satisfaction (Koirala & Shrestha, 2012; Gyawali & Kunwar, 2014; Pradhan & Shrestha, 2017; Lamichhane, 2018). Furthermore, customer satisfaction mediates the relationship between service quality and customer loyalty (Rajeswari, Srinivasulu, & Thiyagarajan, 2017; Gautam & Sah, 2023). Based on the presented evidence, hypotheses of this study have been formulated as follows:

- H<sub>1</sub>**; There is positive relationship between banking service quality and customers' satisfaction.
- H<sub>2</sub>**; Banking service quality has positive relationship with customer loyalty.
- H<sub>3</sub>**; Customer Satisfaction has positive relationship with customer loyalty.
- H<sub>4</sub>**; Customer Satisfaction mediates in the relationship between banking service quality and customer loyalty.

### Research Methodology

This study is based on positivist philosophy and descriptive research design. Primary data has been collected from 384 bank customers of commercial banks operating in Kailali district of Nepal using 5-point Likert-scale questionnaire (*1=strongly disagree to 5= strongly agree*). The pre-tested SERVPERF questionnaire was taken from (Kant & Jaiswal, 2017) for primary data collection. Out of five dimensions of SERVQUAL model, only three dimensions (tangibility, responsiveness and assurance) were taken as service quality. Tangibility was taken as hard aspect of quality; assurance and responsiveness were taken as soft or employee's behavior aspects (Lenka, Saur, & Mohapatra, 2010). 600 questionnaires were distributed via online and field survey using convenience sampling method, out of them 403 questionnaires were returned back (response rate was 67.17 percent). 19 responses were found incomplete and remaining 384 were used thoroughly. Exploratory factor analysis (EFA), confirmatory factor analysis (CFA) and structural equation model (SEM) were computed to analyze the data with the help of statistical package for social science (SPSS) as well as analysis of moment structure (AMOS) software.

### Analysis and Results

The study initially performed exploratory factor analysis (EFA) as first step of structural equation modeling (Hair, Black, Babin, & Anderson, 2010). In first step, sample adequacy and construct reliability, confirmatory factor analysis (CFA) for convergent and discriminant validity was ensured to develop a measurement model. Finally, the structural model was developed.

#### Exploratory factor analysis

Exploratory factor analysis was performed to accomplish the factor solutions. The Kaiser–Meyer–Olkin (KMO) and Bartlett's tests were used to verify the validity of exploratory factor analysis (EFA).

**Table 1**

*KMO and Bartlett's Test for Sampling Adequacy*

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.873
Bartlett's Test of Sphericity	Approx. Chi-Square	5270.969
	Df	210
	Sig.	0.000

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Table 1 shows the Kaiser–Meyer–Olkin (KMO) measure of sampling adequacy and Bartlett’s Test of Sphericity. Here the Chi-square (5270.969, df. 210) is significant ( $p$ -value =.000<.05) and KMO value 0.873 (greater than 0.6) indicates that the sample required for the study is adequate and exploratory factor analysis (EFA) is valid or acceptable for confirmatory factor analysis (Shrestha, 2021).

Kaiser’s Criterion was used to determine number of factors to be extracted. The extraction method of factor analysis used in this study was principal component analysis. The coefficient value less than 0.4 was suppressed for suppressing factor loading less than 0.4. Table 2 shows the factors loadings and number of factors determined as pattern matrix. According to Table 2, five factors have eigenvalue greater than 1 and explained 73.818% total variance. The five factors F1, F2, F3, F4 and F5 explained 33.347% with eigenvalue 7.003, 14.299% with eigenvalue 3.003, 11.464% with eigenvalue 2.407, 9.185% with eigenvalue 1.929 and 5.523 with eigenvalue 1.160 of the total variance respectively. These factors were labeled as customer loyalty (F1), responsiveness (F2), assurance (F3), tangibility (F4) and Customer satisfaction (F5) according to the SERVQUAL dimensions.

**Table 2**

*Pattern Matrix*

Items	Customer Loyalty (F1)	Responsiveness (F2)	Assurance (F3)	Tangibility (F4)	Customer Satisfaction (F5)
Cl_1	0.658				
Cl_2	0.878				
Cl_3	0.962				
Cl_4	0.857				
Cl_5	0.834				
Res_1		0.845			
Res_2		0.867			
Res_3		0.948			
Res_4		0.936			
Ass_1			0.862		
Ass_2			0.892		
Ass_3			0.814		
Ass_4			0.891		

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Tan_1	0.822	
Tan_2	0.880	
Tan_3	0.876	
Tan_4	0.784	
Cs_1		0.847
Cs_2		0.855
Cs_3		0.818
Cs_4		0.624

Extraction Method: Principal Component Analysis.

Rotation Method: Promax with Kaiser Normalization.

Rotation converged in 5 iterations.

### Reliability and validity analysis

#### *Item reliability*

The internal consistency was confirmed by calculating Cronbach's alpha to test the item reliability. The rule of thumb for threshold value of Cronbach's alpha is it should be  $> 0.7$ . In Table 3 the component tangibility, responsiveness, assurance, customer satisfaction and customer loyalty have Cronbach's alpha values 0.862, 0.928, 0.886, 0.834 and 0.898 respectively, which confirmed the reliability of the survey instrument. The Cronbach's alpha value for overall scale reliability is  $0.875 > 0.7$ . It shows that the variables are internally consistent and reliable.

#### *Convergent validity and composite reliability*

The convergent validity is established when average variance extracted (AVE) is 0.5 and composite reliability (CR) should be greater than 0.6 (Fornell & Larcker, 1981; Hair, et al., 2010). The AVE values corresponding to the components; tangibility, responsiveness, assurance, customer satisfaction and customer loyalty are 0.618, 0.760, 0.670, 0.561 and 0.680 respectively. Average variance extracted (AVE) 0.5 confirms the convergent validity and it can be seen that all the AVE values presented in Table 3 are greater than 0.5. The composite reliability (CR) value for component tangibility, responsiveness, assurance, customer satisfaction and customer loyalty are 0.865, 0.926, 0.890, 0.837 and 0.901 respectively. It evidences the internal consistency in scale items. Hence, it can be concluded that there is no issue of convergent validity and composite reliability.

**Table 3**  
*Reliability and Convergent Validity Analysis*

Variable	Item	Standard Loading	Cronbach's Alpha	Composite Reliability	AVE
Tangibility	Tan_1	0.701	0.862	0.865	0.618
	Tan_2	0.885			
	Tan_3	0.797			
	Tan_4	0.749			
Responsiveness	Res_1	0.752	0.928	0.926	0.760
	Res_2	0.847			
	Res_3	0.940			
	Res_4	0.935			
Assurance	Ass_1	0.810	0.886	0.890	0.670
	Ass_2	0.866			
	Ass_3	0.741			
	Ass_4	0.852			
Customer Satisfaction	Cs_1	0.747	0.834	0.837	0.561
	Cs_2	0.749			
	Cs_3	0.741			
	Cs_4	0.760			
Customer Loyalty	Cl_1	0.715	0.898	0.901	0.680
	Cl_2	0.856			
	Cl_3	0.899			
	Cl_4	0.747			
	Cl_5	0.788			

Note: AVE: Average variance extracted.

#### ***Discriminant validity***

Convergent validity establishes that items get converged to same factors; discriminant validity of the constructs establishes that the items do not get converged to other factors which simply mean how far one construct is distinct from the other one. In this study discriminant validity was examined by comparing the square root of AVE of the constructs and the correlation coefficient between constructs. Square root of AVE should be greater than inter-construct correlation coefficient (Fornell & Larcker, 1981;

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Hair et al., 2010). Table 4 shows the results of discriminant validity. The square roots of AVE for each construct presented in diagonal values of Table 4 were greater than the correlation coefficients between the constructs, so implying discriminant validity. These results demonstrate that the reliability and validity criteria were satisfied.

**Table 4**

*Discriminant Validity*

	TAN	RES	ASS	CS	CL
TAN	.786				
RES	.230	.872			
ASS	.014	.074	.819		
CS	.426	.479	.07	.749	
CL	.230	.469	.081	.676	.825

Note: TAN: Tangibility; RES: Responsiveness; ASS: Assurance; CS: Customer Satisfaction; CL: Customer Loyalty.

**Model fit summary**

The model fit for CFA was examined goodness of fit (GOF) indices value. To measure the GOF, some of the most commonly used fit indices such as chi-square ( $\chi^2$ ), normed chi-square ( $\chi^2/Df$ ), comparative fit index (CFI), goodness of fit index (GFI), adjusted goodness of fit index (AGFI), normed fit index (NFI) and root mean square of approximation (RMSEA) were considered to assess the model fit(Hair, Black, Babin, & Anderson, 2010). Table 5 indicates the study model values are within the recommended values except chi-square, i.e., chi-square  $\chi^2(183, N=384)=468.316$ , normed chi-square ( $\chi^2/Df$ ) = 2.559 (<3), normal fit index (NFI) = 0.923 (>0.9), comparative fit index (CFI) = 0.945 (>0.9),root mean square error of approximation (RMSEA) = 0.064 (<0.08), goodness of fit index(GFI) =0.90 ( > 0.90),adjusted goodness of fit index (AGFI)=0.868 (>0.8) and parsimony normed fit index (PNFI)=0.796 (>0.5).Chi-square is one of the basic statistics used to determine the model fit based on the *p*-value, it is not possible for all the models to have significant *p*-value. Therefore, researchers have recommended considering normed chi-square ( $\chi^2/Df$ ) referred to be less than three. The chi-square  $\chi^2(183, N=384) = 468.316$ , which *p*-value (0.000) less than 0.05 or out of acceptable value, it indicates the model was not good fit but the normed chi-square value was 2.559 which was in acceptable range or less than 3, it indicates CFA or measurement model as good

fit. Since the almost indices of GOF were acceptable, the structural equation model was fitted for testing hypotheses. The structural equation model is presented in Figure 2.

**Table 5**

*Model Fit Summary*

Indices	Acceptable Value	Observed Value
Chi-square ( $\chi^2$ )		468.316
Df		183
p-value	>.05	0.000
Absolute goodness of fit		
GFI	> 0.90	.90
RMSEA	<.08	.064
RMR	<.05	.029
Normed chi-square (GMIN/df)	<3	2.559
Incremental fit measure		
NFI	> 0.9	.913
CFI	> 0.9	.945
Parsimony fit measures		
AGFI	> 0.08	.868
PNFI	> 0.5	.796

**Structural equation model**

After determining the measurement model validity, the structure equation modeling was fitted to analyze the relationships among the study variables. Figure 2 presents the parameter estimates for the hypothesized relationships of the structural model. Three dimensions (tangibility, responsiveness & assurance) of service quality were measured to test the relationship between customer satisfaction and customer loyalty. The standardized coefficients ( $\beta$ ) of dimensions determining service quality were as; tangibility;  $\beta = 0.483$  (p-value =  $0.000 < 0.05$ ), responsiveness;  $\beta = 0.659$  (p-value =  $0.000 < 0.05$ ) and assurance;  $\beta = 0.093$  (p-value =  $0.159 > 0.05$ ). The coefficients showing effect of overall service quality on customer satisfaction;  $\beta = 0.769$  (p-value =  $0.000 < 0.05$ ) and on customer loyalty;  $\beta = 0.320$  (p-value =  $0.045$ ). The coefficients showing effect of customer satisfaction on customer loyalty;  $\beta = 0.429$  (p =  $0.002 < 0.05$ ). From the presented results, service quality was determined by tangibility and responsiveness. Since, the coefficient  $\beta = 0.093$ , p-value =  $0.159 > 0.05$ ; assurance has

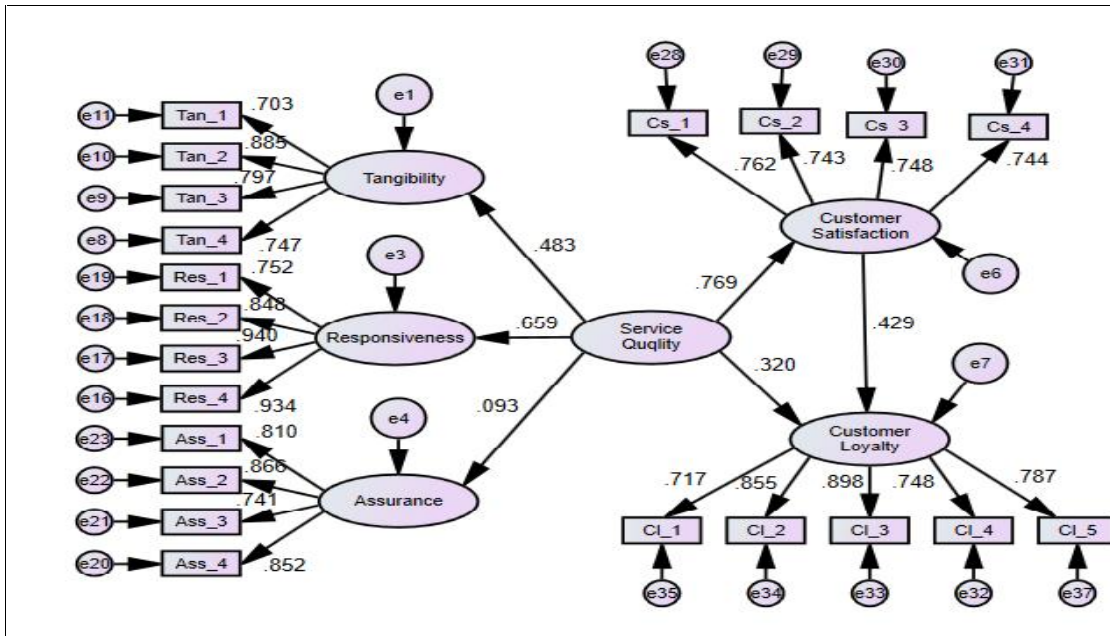
weak and insignificant relationship with service quality. Developed hypotheses (H<sub>1</sub>, H<sub>2</sub> and H<sub>3</sub>) were supported or, there is positive relationship between service quality and customer satisfaction, service quality and customer loyalty, customer satisfaction and customer loyalty. Table 6 represents the summary of hypotheses testing.

**Mediation effect of customer satisfaction**

For testing mediation effect of customer satisfaction between service quality and customer loyalty, bootstrap was computed. As shown in Table 7, coefficient of total effect of service quality;  $\beta = 0.505$  (p-value = 0.000<0.05), direct effect;  $\beta = 0.32$  (p-value = 0.045<0.05) and indirect effect  $\beta = 0.33$  (p-value = 0.025<0.05) on customer loyalty. The direct effect must be smaller than the total effect and full mediation is achieved when direct effect becomes insignificant. If direct and indirect both effect appear significant, there is partial mediation effect of mediator variable(Boran & Kenney, 1986).Since the direct and indirect effect both were significant, it can be concluded that customer satisfaction has partial mediation between service quality and customer loyalty in banking sector of Nepal.

**Figure 2**

*Structural Equation Model*



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**Table 6**  
*Hypothesized Path Coefficient Test*

Relationship	Estimate	C.R.	P-value	Result
H <sub>1</sub> : SQ → CS	0.769	5.408	0.000	Supported
H <sub>2</sub> : SQ → CL	0.320	2.003	0.045	Supported
H <sub>3</sub> : CS → CL	0.429	3.111	0.002	Supported
H <sub>4</sub> : SQ → CS → CL	0.330	1.241	0.024	Supported

**Note:** CS- Customer Satisfaction, SQ- Service Quality, CL- Customer Loyalty, C.R. - Critical Ratio.

**Table 7**

*Total, Direct and Indirect Effect of Service Quality on Customer Loyalty*

Variables	Total Effect	Direct Effect	Indirect Effect
SQ → CL	0.505 <sup>***</sup>	0.32 <sup>**</sup>	0.33 <sup>**</sup>

**Note:** 1. CL- Customer Loyalty, SQ- Service Quality.

2. <sup>\*\*</sup> significant at 5% level, <sup>\*\*\*</sup> significant at 1% level

### Discussion and Implications

This study empirically examined the relationship between banking service quality, customer satisfaction and customer loyalty in Nepalese banking sector. Furthermore, it analyzed the mediating effect of customer satisfaction between banking service quality and customer loyalty. The findings of the study indicated that there is significant positive relationship between banking service quality, customer satisfaction and customer loyalty. In addition this study has determined the partial mediation effect of customer satisfaction in the relationship of banking service quality and customer loyalty. These findings are consistent with previous studies of (File & Prince, 1992; Lenka, Saur, & Mohapatra, 2010; Mosahab, Mahamad, & Ramayah, 2010; Pradhan & Shrestha, 2017; Tee, Preko, & Tee, 2018; Gautam & Sah, 2023). ). It is also supported by the theory of customer satisfaction and loyalty; higher level service quality leads the higher customer satisfaction and loyalty. Since, the strong positive linkages have been apparent between service quality, customer satisfaction and customer loyalty; increases/improved banking

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service quality leads to increase the customer satisfaction and loyalty (Anderson & Sullivan, 1993). The bootstrap result for direct and indirect effect of service quality on customer loyalty showed that there both effect exist. Therefore, service providers should be aware about the improvement of customer satisfaction and service quality. Satisfied customers strengthen the organization's competitive power (Oliver, 1999).

The findings of this study will be useful to decision makers of Nepalese banking sector in respect to improve service quality and improve customer loyalty. It will also provide insight to commercial banks manager to understand customer perception about banking service quality in Nepalese context. The findings therefore serve as a guide to give practitioners a balance between undue manipulation of the relatively more expensive traditional hard elements of the marketing and promotional mix elements and the cheaper soft issues related to employees. This is because the attitudes and behaviors of employees contribute significantly towards improving the service quality dimensions (Responsiveness and Assurance). Addressing these factors will lead to improvements in overall service quality, which in turn positively impacts customer satisfaction and loyalty. A practical implication of this study results is that it has provided critical issues for bank managers to focus on their customer's satisfaction in order to compete favorably in the Nepalese banking sector. Bank managers must focus and communicate their service quality in terms of tangibility and responsiveness in order to meet customer's expectation, satisfaction and loyalty.

### **Limitations and Directions for Future Research**

This study has focused on service quality, customer satisfaction and loyalty in Nepalese commercial banks. It has covered only three dimensions (tangibility, responsiveness and assurance) of SERVQUAL model presented by (Parssuraman, Berry, & Zeithaml, 1988). Tangibility was taken as hard aspect of quality; assurance and responsiveness were taken as soft or employee's behavior aspects. Future researchers can conduct their study focusing on all five dimensions of service quality. Simple mediation of customer satisfaction in relationship between service quality and customer loyalty was used to analyze the data of the study, so future researchers can apply parallel and serial mediation effect using more mediating variables. Effect of moderator variables on satisfaction and loyalty can also be applied for same study. This study has covered only



banking sector of Nepal, further studies can be conducted in the area of other service sector to measure their service quality, customer satisfaction and loyalty.

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