

The Role of Perceived Service Quality and Islamic Financial Literacy on Customer Loyalty In NTB Syariah Bank

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Abstract

Islamic banks need to develop strategies to increase customer loyalty. It prevents customers from switching to other banks and ensures business survival. This is especially true for Islamic regional banks with relatively homogeneous customer bases. This study investigates the impact of perceived service quality and Islamic financial literacy on customer loyalty in NTB Syariah Bank, which is recognized for its excellence in regional banking. Through purposive sampling, data is gathered via questionnaires from 85 respondents after filtering through 112 respondents and analysed using Structural Equation Modelling (SEM). Key findings reveal that service quality significantly influences customer loyalty, with empathy and tangibility emerging as crucial factors. Empathy is crucial in fostering positive customer experiences and building long-term relationships. A high level of tangibility can enhance customer confidence and satisfaction. Additionally, the study underscores the positive correlation between service quality, Islamic financial literacy, and customer loyalty. Practical implications highlight the importance of enhancing financial literacy and fostering trust in Islamic banking through regulatory support and educational initiatives. This research fills a gap in understanding regional bank practices and offers insights for tailored financial literacy programs in rural communities.

Keywords:

Service Quality, Islamic Financial Literacy, Customer Loyalty, Islamic regional Banks

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1. Introduction

The Islamic banking landscape in Indonesia is experiencing significant growth in the broader banking industry. Despite constituting just over 6% of the approximately \$634 billion assets in Indonesia's banking sector, Islamic banking has witnessed a remarkable expansion in recent years (Suroyo & Diela, 2021). Savings held in Islamic banks surged by an impressive 80% from the end of 2018 to March 2021, surpassing the growth rate of their conventional counterparts, while financing activities also outpaced conventional loan growth during the same period (Suroyo & Diela, 2021). With Indonesia, home to the world's largest Muslim population, the traction gained through Islamic banking is noteworthy. Bank Indonesia has underscored a notable 65% increase in Islamic banking assets over the last five years, signalling a growing acceptance and preference for Sharia-compliant financial services among Indonesian consumers (Rizvi et al., 2020). This upward trajectory highlights the potential for the further development and integration of Islamic banking within Indonesia's financial landscape.

Thus, Islamic banking is a rapidly growing industry in countries where most of the population follows the Muslim faith. Unlike conventional banking, Islamic banks do not charge an interest in loans. Instead, they operate on a profit- and loss-sharing basis following Islamic principles. While the global market share of Islamic banking assets is relatively small, at 1.5%, it has experienced remarkable growth. Between 2006 and 2011, Islamic banking institutions' assets doubled, reaching \$900 billion (Financial Times, 2011; Mohammed *et al.*, 2015). 2019 Shariah-compliant assets rose, reaching \$2.5 trillion compared to \$2.4 trillion in 2018. Experts predict that 2024 these assets will further increase to \$3.5 trillion. Islamic banks play a significant role in the broader Islamic finance sector, contributing 70% of total Islamic finance assets, amounting to \$1.76 trillion (IFDR, 2019). This growth signifies increasing popularity and acceptance of Islamic banking principles, reflecting a shift in financial preferences and rising demand for Sharia-compliant financial services.

According to the Future of World Religions, Indonesia's Muslim population is approximately 87% (Global Religious Future, 2020). In the same year, West Nusa Tenggara (NTB) Province reported that it constituted 96% of the population (One Data NTB, 2020). This contrasts with the Indonesian banking market share, which non-Islamic financial institutions dominate. However, citizens prefer to use conventional banks, as proven by the percentage of Islamic banking market share of 5.99% obtained in March 2020 (OJK, 2020). Although the people of West Sumba know usury, they still prefer conventional banks (Fatoni & Luik, 2021).

Therefore, Islamic banks need to determine ways to enhance their performance by improving customer loyalty, which is relevant for the survival of businesses and prevents customers from switching to another bank (Kartika *et al.*, 2019). In the Bisnis Indonesia Financial Award (BIFA) 2023, Bank NTB Syariah was selected as the recipient of the award for The Best Performance Bank in the category of Regional Development Banks with Assets less than 15 trillion (bankntbsyariah.co.id). This accolade signifies the recognition of the outstanding performance and achievements of Bank NTB Syariah in catering to the needs of Islamic banking in its region. With this acknowledged performance, researching Bank NTB Syariah becomes highly intriguing regarding how an Islamic banking institution serves its clients and whether it influences customer loyalty. Previous research has shown that customer loyalty positively affects business performance (Soltanmoradi *et al.*, (2013). Meanwhile, loyal customers are satisfied with the quality of the service rendered by a

company, which causes them to repurchase (Ul et al., 2020). According to *Kartika et al.* (2019), this factor influences customer loyalty.

Nunkoo *et al.* (2017) treat service quality as a second-order factor. They analyzed the effect of service quality on customer satisfaction, perceived value, image, consumption emotions, and customer loyalty. This study was conducted on South Africa's accommodation industry. Butt and Aftab (2013) analyzed the relationship between perceived service quality, customer satisfaction, and loyalty. They used the five-dimensional model developed by Parasuraman *et al.* (1985): reliability, empathy, tangibility, assurance, and responsiveness. Furthermore, Othman and Owen (2001) proposed compliance dimensions with Islamic values using the CARTER model.

Research on service quality and customer loyalty has been conducted in Islamic banks outside Indonesia, including Malaysia. Abedniya and Zaeim (2011) discovered that the CARTER model was a good determinant of customer satisfaction. De Bruinet *et al.* (2021) conducted a similar study in Oman and reported a significant correlation between customer satisfaction and perceived service quality. Furthermore, Alshurideh *et al.* (2017) researched Jordanian Islamic banks and reported that service quality positively affected customer loyalty.

It also influences bank image and customer perspectives, causing them to be loyal, as reported in a study conducted in Palestine (Abd Ghani *et al.*, 2017). Janahi and Al Mubarak (2017) conduct research on banking in Bahrain. They found a strong and positive relationship among six dimensions of customer service quality: compliance, assurance, reliability, tangibility, empathy, and responsiveness to customer satisfaction. Asnawi *et al.* (2020) analyzed the dimensions of Islamic value, Shariah compliance, honesty, modesty, humaneness, and trustworthiness of service quality in Islamic commercial banks in Indonesia.

Research on Islamic financial literacy (IFL) has been carried out in different areas by measuring its impact on the intention to use Islamic banking (Albaity & Rahman, 2019), young customers' decisions (Austin & Arnott-Hill, 2014; Fraczek & Klimontowicz, 2015), and financial skills, attitudes, and behaviours (Fraczek & Klimontowicz, 2015).

This study differs from the previous research. Albaity and Rahman (2019), Austin and Arnott-Hill (2014), and Fraczek and Klimontowicz (2015) do not examine the impact of IFLs on customer loyalty. Mandell and Klein's (2009) findings indicate that policymakers must be able to make decisions based on their choices. Customers can make the best choice in terms of banking with the appropriate institution based on their knowledge of finance (Austin & Arnott-Hill, 2014).

Janahi and Al Mubarak (2017) used a study framework in which service quality dimensions were directly related to customer satisfaction. Meanwhile, this study develops a framework in which the service quality dimension relates to the service quality variable and other variables. However, both studies developed a reflective measurement model for the relationship between the service quality variables and their dimensions. In this case, the direction of the arrow moves from the variable to the variable (Hair *et al.*, 2017).

This study aims to bridge several gaps identified in the existing literature on service quality, Islamic financial literacy (IFL), and customer loyalty within the context of Islamic regional banks in Indonesia, focusing specifically on NTB Syariah Bank. Regarding performance, the NTB Syariah Bank is one of the best Islamic financial institutes in ASEAN and is ranked 14th by The Asian Banker (SuaraNTB.com, 2021). While prior research has extensively explored the relationship between service quality and customer loyalty in

various industries and regions, more studies are still needed to address this relationship within the unique setting of regional Islamic banks in Indonesia. Additionally, there needs to be a more significant gap in understanding the influence of Islamic Financial Literacy on customer loyalty, particularly in the Indonesian Islamic banking sector. Furthermore, while previous studies have employed different frameworks and measurement models to assess the relationship between service quality dimensions and customer satisfaction, this study introduces a novel framework that examines the relationship between service quality, its dimensions based on the CARTER model, and other variables such as IFL and customer loyalty. By focusing on a rural community with homogeneous characteristics, this study fills a gap in understanding the dynamics of Islamic banking within such contexts, offering valuable insights for academia and industry practitioners.

This paper has several sections: introduction, method, results, and conclusions. This paper begins with an introduction that sets the study by presenting the research phenomenon and conducting a thorough review of the relevant literature, thereby identifying a research gap and establishing clear research objectives. The method section outlines the specifics of the study, including the sample size, characteristics of the sample used, chosen data analysis technique, and conceptual framework guiding the research. Subsequently, the results section presents the findings obtained through structural equation modelling (SEM) using Partial Least Squares (PLS) analysis and discussions on outer measurement, hypothesis measurement results, and their implications. Finally, the conclusion summarizes the key findings, underscores their significance in addressing the research gap, and offers insights for future research avenues and practical applications, thus providing a comprehensive overview of the organization and progression of the study.

Islamic financial literacy

Islamic Financial Literacy plays a vital role in Islamic banks' growth. La Bella and Malyaev (2014) discovered that these institutions tend to grow in Russia due to the increasing level of Islamic financial literacy in society. They stated that when non-Muslims began to understand the functions of a financial institution based on Islamic teachings, the number of customers grew. This was examined by determining true and false statements (Albaity & Rahman, 2019). First, Islamic financial literacy consists of a Muamalah contract, which is knowledge of Islamic bank products (Albaity & Rahman, 2019). It focuses on murabahah (Rahim *et al.*, 2016), mudharabah (Albaity and Rahman, 2019), ijarah (Albaity and Rahman, 2019); (Albaity and Rahman, 2019), Qard Hassan (Albaity and Rahman, 2019), and Istishna (Albaity and Rahman, 2019). Second, it is associated with the prohibition of Islamic finance (Albaity & Rahman, 2019), which is the knowledge of riba (Setiawati *et al.*, 2018); (Albaity & Rahman, 2019); (Setiawati *et al.*, 2018), and wealth hoarding (Rahim *et al.*, 2016).

Although no study has precisely measured the impact of Islamic financial literacy on customer loyalty, some studies have been conducted in similar areas. Albaity and Rahman (2019) concluded that an indirect relationship exists between Islamic financial literacy and the decision to select this banking system. Based on this review, the research hypotheses were as follows:

H1: Islamic financial literacy has a positive influence on customer loyalty.

Service Quality

Service quality depends on customer expectations and is considered high if it can exceed customers' wishes (Fared *et al.*, 2021). However, its fulfillment requires simultaneous consideration from the perspective of both customers and service providers in the form of an interactive construct (Ramya *et al.*, 2019). Therefore, service quality is an abstract and measurable multidimensional attribute but measurable (Zeithaml, 1988).

Several service-quality models have been proposed by researchers, including Parasuraman *et al.* (1985). They develop a service quality model using a five-dimensional approach: reliability, empathy, tangibility, assurance, and responsiveness. The SERVQUAL model is currently under development. Cronin and Taylor (1992) developed the SERVQUAL model using a performance-based approach. They proposed this approach using SERVPERF. Adapting to the development of Islamic economics and finance, Othman and Owen (2001) proposed dimensions of compliance with Islamic values using the CARTER model. The full CARTER is an acronym for compliance, assurance, reliability, tangibles, empathy, and responsiveness. Raajpoot (2004) proposed PAKSERV. He developed the SERVQUAL dimension while maintaining tangibility, reliability, and assurance and replacing responsiveness and empathy with three other attributes: formality and personalization.

Research on the application of the service-quality model was conducted by Kishada and Wahab (2013). They concluded that a significant relationship exists between service encounters, experiences and dependability, social and convenience values, trust, reliability, satisfaction, expectations, and loyalty. Kashif *et al.* (2015) research Malaysian Islamic Banking and examine the impact of the PAKSERV measure on satisfaction and loyalty. They discovered that all the dimensions were validated, except for reliability. Amin and Isa (2008) found that compliance, assurance, responsiveness, tangibility, empathy, and reliability can significantly explain the dimensions of service quality.

Amin and Isa (2008) examined the relationship between service quality perception and customer satisfaction in Malaysian Islamic Banking. The results showed that they were satisfied with the service quality. Therefore, these six dimensions were good determinants of customer satisfaction. Abedniya and Zaeim (2011) assess perceived service quality using the difference between customer expectations and perceptions of Malaysian Islamic Banking. It was concluded that there was a significant change between perceptions and expectations concerning reliability, empathy, tangibility, assurance, responsiveness, and compliance. According to its needs, this study uses the CARTER approach to analyze service quality.

Compliance.

Compliance plays an important role in Islamic banking. The Sharia Board ensures its implementation and oversees the contracts used to run the funding and financing processes. Periodic audit processes are required to ensure that Islamic bank stakeholders comply with Islamic law. This dimension has certain indicators, namely the availability of zakat payment facilities, and customers pay zakat using facilities provided by the Islamic bank (Amin and Isa, 2008). Contracts are in accordance with Islamic principles (Othman and Owen, 2001) as well as OJK and Bank Indonesia regulations (Kartika *et al.*, 2019), and Sharia rule implementation, which needs to be adopted in contracts and product services (Firdaus, 2017).

Assurance.

Assurance refers to employees' ability to inspire trust and confidence through their knowledge and courtesy (Schneider *et al.*, 2004). It has the following indicator: safe transactions (Amin and Isa, 2008), meaning that Islamic bank employees are trustworthy in

handling customer complaints and problems (Butt and Aftab, 2013). This is followed by attitudes (Amin and Isa, 2008); (Alshurideh *et al.*, 2017), indicated by their friendliness and politeness when dealing with their clients (Hussein, 2015) and providing financial advisory provisions (Kartika *et al.*, 2019), which shows that they tend to offer financial advice and support (Hussein, 2015).

Reliability.

Reliability is described as delivering promised performance dependably and accurately (Schneider *et al.*, 2004). Organizations are advised to strive to make customers feel comfortable. Reliability indicators are promising service provisions (Kartika *et al.*, 2019); (Amin and Isa, 2008), meaning that Islamic banks have friendly employees (Parasuraman *et al.*, 2010) who are reliable in providing information and handling customer problems efficiently (Kashif *et al.*, 2016). It also has convenient business hours to render services with accurate records, which means that the data obtained during transactions are valid (Alshurideh *et al.*, 2017).

Tangibility.

Tangibility is the appearance of an organization's facilities, employees, equipment, and communication materials (Schneider *et al.*, 2004). It is important for an establishment to pay attention to attributes that are visible to the customer. According to Hussein and Hapsari (2015), employees must be neatly and appropriately dressed while professionally and effectively communicating with customers (Kashif *et al.*, 2016); (Kartika *et al.*, 2019). Furthermore, Islamic bank facilities need to be kept clean, comfortable, and properly maintained buildings and the environment (Kashif *et al.*, 2016).

Empathy.

Empathy is described as personalized attention given to customers (Schneider *et al.*, 2004). Organizations need to be able to understand each of their customers and decipher their needs while providing provision for the use of Internet banking and ATM services available for 24 h (Parasuraman *et al.*, 2010); (Amin and Isa, 2008).

Responsiveness.

Responsiveness is an organization's willingness to provide prompt services (Schneider *et al.*, 2004). They must respond to customers by striving to meet their needs. These indicators are prompt services and help employees of Islamic banks render their services to meet customer expectations (Alshurideh *et al.*, 2017). They are also willing to respond to feedback (Butt & Aftab, 2013).

This study develops the relationship between service quality and its dimensions: compliance, assurance, responsiveness, tangibility, empathy, and reliability, as the second-order service quality factor model and the sub-dimensions are interconnected. Research on second-order service quality in banking includes Nunkoo *et al.*(2017), who found that the second-order factor quality model is empirically and conceptually acceptable. Hussein and Hapsari (2015) found that interaction, outcome, and physical quality can be service quality dimensions formed in a hierarchical model. Service quality is a strong determinant of the corporate image and customer loyalty. Asnawi *et al.* (2020) found that Islamic values, Sharia compliance, honesty, modesty, humaneness, and trustworthiness are suitable service quality

dimensions. Service quality positively affects customer satisfaction. Based on this review, the research hypotheses were as follows:

H2: Six sub-dimensions of service quality, namely, compliance, assurance, responsiveness, tangibility, empathy, and reliability, are related to service quality, which the second-order service quality factor model can explain.

Customer Loyalty

Customer loyalty is a more precise tool for measuring repurchases than customer satisfaction and loyalty (Griffin, 2005). In other words, being satisfied does not mean that customers intend to use a similar product, whereas loyalty means continuous use of the same product. Meanwhile, in service businesses such as banking, loyalty is also an important key for excelling in highly competitive markets. Loyal customers demonstrate their intention to not use other banks, irrespective of the attractive products offered (Chinomona, 2016)

Loyalty has certain indicators, such as the customer's zeal to recommend Islamic banking to relatives, meaning that they are willing to persuade their friends and family members (Alshurideh *et al.*, 2017; Butt and Aftab, 2013). This is in addition to their ability to continuously carry out transaction processes because the bank is believed to be safe (Kartika *et al.*, 2019); (Alshurideh *et al.*, 2017). According to Butt and Aftab (2013) (Kartika *et al.*, 2019), customers choose to deal with Islamic banks. This also implies that they intend to continue using Islamic banks (Suhartanto *et al.*, 2019), have positive conversations, and provide high-quality services (Kashif *et al.*, 2016), thereby boosting their image (Kartika *et al.*, 2019).

Previous research has been conducted on customer loyalty, including Butt and Aftab (2013), who investigated the influence of customer attitudes and the relationships among e-satisfaction, e-loyalty, e-trust, and e-service quality. They conclude that attitude significantly influences e-satisfaction and perceived e-service, whereas e-loyalty and e-satisfaction are mediated by e-trust. (Suhartanto *et al.*, 2019) reported that religiosity and emotional factors substantially influenced loyalty. Service quality also had a direct effect on customer satisfaction. Alnaser *et al.* (2017) studied customer loyalty. The findings showed that customer satisfaction impacts the bank's image and customer loyalty and is also affected by the quality of services.

Sulibhavi and Shivashankar (2017) assessed the impact of brand image, trust, and customer loyalty on a private label brand in Hubli-Dharwad, Conglomerate City. They discovered a significant relationship between the three attributes. Maulana and Sciences (2016) investigated the influence of halal brand awareness on loyalty to Islamic Banking and found a significant effect.

Most previous research has found that service quality indirectly impacts customer loyalty; typically, researchers examine its impact on customer satisfaction and loyalty. Research examining the direct impact of service quality on customer loyalty is rare, as has been conducted by Fida *et al.* (2020) and Alshurideh *et al.* (2017). Their results show that service quality can directly predict customer loyalty. Ul Haq and Awan (2020) examined the influence of e-service quality on customer loyalty during a pandemic. Reliability and website design are crucial implementations of services rendered to customers to gain loyalty. Another study found that service quality directly influences customer loyalty (Alshurideh *et al.*, 2017; Fida *et al.*, 2020). Based on this review, the research hypotheses were as follows:

H3: Service quality has a positive influence on customer loyalty.

This study applied the second-order construct to the first model to examine the relationship between service quality and its six dimensions. The framework of the developed model is illustrated in Figure 1.

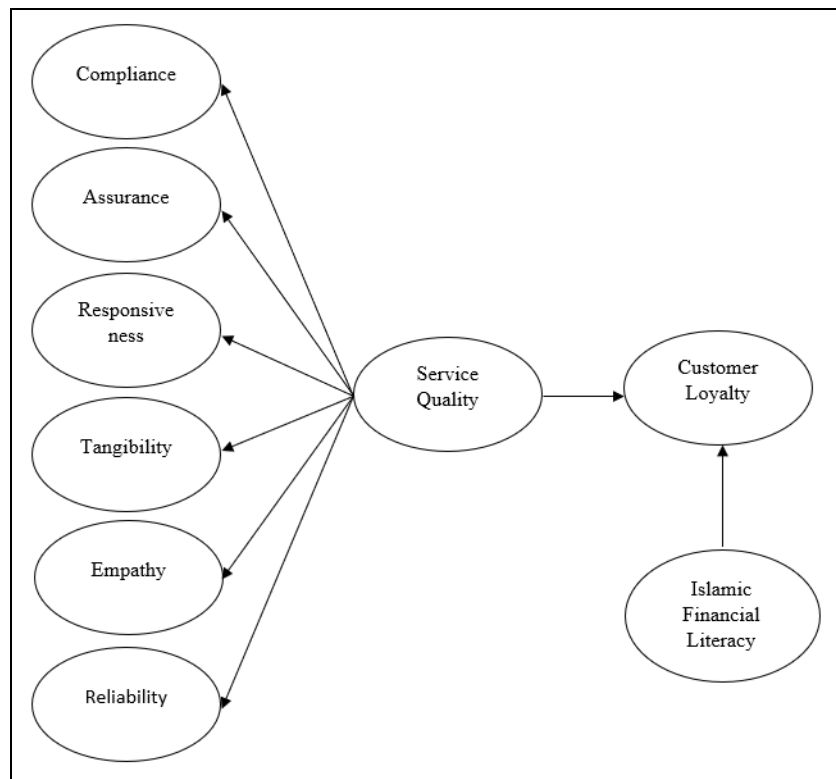


Figure 1. Research Framework

2. Method

Based on a literature review and previous studies, especially those focusing on customer loyalty to Islamic banking, this study develops and tests the conceptual model shown in Figure 1. Thus, the variables in this study are limited by the model originating from the CARTER measurement scale, which encompasses six dimensions designed to gauge the quality of services provided by Islamic banks: compliance, assurance, reliability, tangibles, empathy, and responsiveness. This scale was selected because of its comprehensive nature and specific relevance in evaluating the quality of services provided by Islamic banks. To measure the dimensions of each variable, this study used a combination of measures and scales adapted from the validated instruments used in previous studies.

Compliance was assessed using items related to adherence to Islamic principles and regulations governing banking practices. The items were adapted from previous studies by Amin and Isa (2008), Kartika *et al.* (2019), Othman and Owen (2001), and Firdaus (2017). Assurance was measured using items gauging customer confidence in a bank's integrity and competence. The items were adapted from previous studies by Alshurideh *et al.* (2017), Hussein (2015), Amin and Isa (2008), and Othman and Owen (2001). Reliability is evaluated using indicators of consistency and dependability in service delivery. The items used were adapted from previous studies by Kashif *et al.* (2016), Amin and Isa (2008), Alshurideh *et al.* (2017), Ul Haq and Awan (2020), Parasuraman *et al.* (2010), and Othman and Owen (2001).

Tangibles were assessed using items related to physical facilities, equipment, and appearance of the bank. The items were adapted from previous studies by Alshurideh *et al.* (2017), Othman and Owen (2001), Amin and Isa (2008), Kashif *et al.* (2016), and Hussein (2015). Empathy was measured through items that capture a bank's ability to understand and address customers' needs. The items were adapted from previous studies by Othman and Owen (2001), Alshurideh *et al.* (2017), Parasuraman *et al.* (2010), Loonam and O'Loughlin (2008), Butt and Aftab (2013), and Amin and Isa (2008). Finally, responsiveness was assessed by evaluating the bank's promptness and willingness to assist its customers. The items were adapted from previous studies by Alshurideh *et al.* (2017), Othman and Owen (2001), Amin and Isa (2008), and Hussein (2015).

The selection of measurement scales was justified based on their alignment with the theoretical underpinnings of this study. The validity and reliability of measurement scales have been demonstrated in previous research, particularly related to Islamic banking and service quality assessments. The conceptual model proposed in Figure 1 outlines the relationship between service quality, Islamic financial literacy, and customer loyalty, utilizes insights from the literature, and investigates various hypotheses.

The research object is the NTB Syariah Bank, an Islamic regional bank in Nusa Tenggara Barat Province, Indonesia. It was ranked 14th by The Asian Banker (SuaraNTB.com, 2021). The questionnaires were written in Indonesian, and a predetermined amount was distributed to the respondents (customers of the NTB Syariah Bank). Purposive sampling was used in this study. According to Roscoe (1982), the sample must be at least ten times the number of variables. Subsequently, eight variables were analyzed, and the number of samples realized was eight times ten, equal to 80. The sample requirements are customers of the NTB Syariah Bank who are over 18 years old.

One hundred twelve respondents filled out the questionnaire, but only 85 complete responses were received and considered for analysis, resulting in an overall response rate of 75.89%. While this response rate exceeds the typical positive outcome range of 20% to 30% for mail-out surveys, as suggested by Akintoye and Fitzgerald (2000), it should be noted that achieving such a high response rate is particularly noteworthy given the challenges often associated with survey participation.

The survey instrument was developed using Google Forms and was self-administered. A questionnaire link was distributed to potential respondents on various social media platforms. Additionally, to ensure a diverse and representative sample, the researcher enlisted the assistance of acquaintances who had connections with the customers of the NTB Syariah Bank. Despite using an online platform to distribute the questionnaire, this method did not result in an adequate sample size.

Consequently, efforts were made to interact directly with Bank NTB Syariah customers to ensure a sufficient sample size. Efforts were made through direct face-to-face meetings. The respondents were asked to complete a questionnaire. The research sample will include customers whose profiles align with the survey criteria. A meeting was conducted when a customer visited Bank NTB Syariah. The collected responses were reviewed, verified, and coded to facilitate data analysis. Another objective of combining the methods of distributing questionnaires online and interacting directly with bank customers is to capture a broader spectrum of perspectives and ensure the greater validity and reliability of the study findings.

The hypothesis was tested using the SEM-PLS and SmartPLS software. Structural equation Modelling (SEM) explains phenomena involving two or more variables. These variables can be treated as exogenous and endogenous latent. Exogenous latent variables

explain the other constructs in the model. Endogenous latent variables are constructs explained by other constructs in the model (Hair *et al.*, 2021); Kilne (1998). In this study, service quality and Islamic financial literacy were exogenous variables. Customer loyalty, on the other hand, is an endogenous variable.

In addition, SEM can be used to test the proposed model of variables to determine the error in measuring variables and the pathways between variables. SEM allows researchers to check the reliability and validity of each variable's measurement in a model (Tompson *et al.*, 1995). Therefore, SEM can help researchers better estimate the relationships between variables. Compared with other methods, SEM can integrate theory and practice in a way that other methods, such as multiple regression, factor analysis, and path analysis, cannot.

Structural equation modelling (SEM) involves five main steps (Norman & Streiner, 2003). The model specification describes the relationships between the latent variables. Model identification ensures that the model describes only variables of interest. The theoretical framework supports the relationship between the variables. The model was then estimated, consisting of a measurement model (outer model) and a structural model (inner model). Perform a test of fit (TF), which checks whether the model accurately predicts responses for different samples. Finally, the model was specified or modified. If the model does not fit, it should be improved by adding or deleting latent variables or adjusting their relationships.

The operational variables used in this study were defined by their indicators, as shown in Table 1.

Table 1. Research Variables

No	Variable	Indicators	Referred to
1.	Islamic financial literacy	a. <i>Free of interest</i>	Rahim <i>et al.</i> (2016); Albaity & Rahman (2019)
		b. <i>Gharar</i>	Albaity & Rahman (2019); Rahim <i>et al.</i> (2016)
		c. <i>Preservation of wealth is allowed in Islam</i>	Albaity & Rahman (2019)
		d. <i>Murabahah</i>	Setiawati <i>et al.</i> (2018)
		e. <i>mudharabah,</i>	Setiawati <i>et al.</i> (2018)
		f. <i>ijarah</i>	Rahim <i>et al.</i> (2016)
		g. <i>qardhassan</i>	Rai <i>et al.</i> (2019)
		h. <i>istishna</i>	Setiawati <i>et al.</i> (2018)
		i. <i>ijarah</i>	Setiawati <i>et al.</i> (2018)
2.	Compliance	a. Availability of <i>zakat</i> payment facilities	Amin & Isa (2008)
		b. Contracts are in accordance with Islamic principles	Kartika <i>et al.</i> (2019); Othman & Owen (2001)
		c. Sharia rules implementation	Firdaus (2017); Othman & Owen (2001)
3.	Assurance	a. safe transaction	Alshurideh <i>et al.</i> (2017); Hussein (2015)

	b. employee's attitude	Amin & Isa (2008); Hussein (2015)
	c. financial advices provision	Othman & Owen (2001); Amin & Isa (2008)
4. Reliability	a. Promising services provision	Kashif <i>et al.</i> (2016); Amin & Isa (2008); Alshurideh <i>et al.</i> (2017)
	b. convenient business hours	Ul Haq & Awan (2020); Alshurideh <i>et al.</i> (2017); Parasuraman <i>et al.</i> (2010)
	c. The record is accurate	Othman & Owen (2001); Parasuraman <i>et al.</i> (2010)
5. Tangibility	a. The appearance of the employee	Alshurideh <i>et al.</i> (2017); Othman & Owen (2001)
	b. The facilities of Islamic bank	Othman & Owen (2001); Amin & Isa (2008); Alshurideh <i>et al.</i> (2017)
	c. Environment	Kashif <i>et al.</i> (2016); Hussein (2015)
6. Empathy	a. Employee's concern	Othman & Owen (2001); Alshurideh <i>et al.</i> (2017)
	b. Understanding of customer need	Alshurideh <i>et al.</i> (2017); Parasuraman <i>et al.</i> (2010); Butt & Aftab (2013)
	c. Internet banking provision	Loonam & O'Loughlin (2008); Butt & Aftab (2013); Amin & Isa (2008)
	d. ATM service provision	Amin & Isa (2008)
7. Responsiveness	a. Prompt service and help	Alshurideh <i>et al.</i> (2017); Othman & Owen (2001)
	b. Fast and efficient services	Amin & Isa (2008); Hussein (2015)
	c. Branch office provision	Amin & Isa (2008)
8. Customer Loyalty	a. To recommend the relatives	Alshurideh <i>et al.</i> (2017); Butt & Aftab (2013); Kashif <i>et al.</i> (2016)
	b. To keep dealing with bank	Kashif <i>et al.</i> (2016); Suhartanto <i>et al.</i> (2019); Kartika <i>et al.</i> (2019)
	c. The bank is the first choice	Butt & Aftab (2013); Alshurideh <i>et al.</i> (2017)
	d. Talk positively about the bank	Kartika <i>et al.</i> (2019); Kashif <i>et al.</i> (2016); Alshurideh <i>et al.</i> (2017)

3. Result And Discussion

Result

Profile of Respondents

Profile of respondents who answered the questionnaire according to various criteria. Male 45% and female 55%. Respondents had the following education: S1 (undergraduates) 34%, SMA (high school) 28%, S2 (master) 21%, S3 (Ph.D) 11%, and D3 (diploma) 6%. Respondents have an income of less than Rp 5 million 67%, between Rp 5 million and Rp 15 million 32%, and more than Rp 45 million 1%. Respondents had been banking customers for less than one

year (36%), more than three years (35%), between one and two years (17%), and 12% between two and three years. The Respondents lived in Lombok Barat 45%, Mataram 28%, Lombok Tengah 11%, Lombok Timur 6%, Bima 6%, Sumbawa 2%, Lombok Utara 1%, Dompu 1%.

Descriptive Statistics

Descriptive analysis provides valuable insights into each variable's central tendency and variability. The mean shows the average score of each respondent's ratings. A higher mean score indicates a higher level of the construct being measured. The Islamic Financial Literacy (IFL) variable had a mean score 3.75. This indicates that the respondents' Islamic financial literacy level was relatively high. All dimensions of the service quality variable, namely, compliance, assurance, reliability, tangibility, empathy, and responsiveness, had a mean score of > 4. This indicates that customers positively view Islamic banking services. The variable Customer Loyalty (CL) has a mean score of > 4. This indicated that the respondents were highly loyal. The standard deviation (SD) measures the dispersion of scores around the mean. Lower SD values indicate that the responses tended to cluster around the mean. This indicates greater homogeneity in respondent responses. Conversely, higher SD values indicated more significant variability in the responses. The SD of Islamic financial literacy has a relatively high value of 0.97. This indicates variability in the level of financial literacy among respondents. The service quality dimensions of compliance, assurance, reliability, physical evidence, and responsiveness had lower SD values. This indicates a more consistent perception of respondents' qualities. The Empathy dimension showed moderate variability, with an SD of 0.88. The same is true for the Customer Loyalty variable, which has an SD of 0.87 (Table 2).

Table 2. Descriptive Statistics

Variable	Mean	SD
IFL	3,75	0,97
Compliance	4,24	0,78
Assurance	4,15	0,79
Reliability	4,11	0,80
Tangibility	4,27	0,75
Empathy	4,05	0,88
Responsiveness	4,21	0,80
CL	4,07	0,87

Measurement model analysis

The instrument's psychometric properties for all constructs were measured using reflective indicators to establish a null model with no structural relationships. This procedure was performed as previously described by Chin (1998), Kleijnen *et al.* (2007), and Asnawi *et al.* (2020). Reliability was evaluated using composite scale reliability (CR) and average variance extracted (AVE) (Fornell & Larcker, 1981; Chin, 1998; Kleijnen *et al.*, 2007; Asnawi *et al.*, 2020). For all measures, the CR was well above the cut-off value of .70. The lowest is assurance (0.884), and the highest is customer loyalty (0.963). AVE exceeds the cut-off value 0.500 (Fornell & Larcker, 1981; Hair *et al.*, 2017). The lowest is assurance (0.603), and the highest is customer loyalty (0.813). This implies that the variance of the indicator that forms the latent variable was greater than 50% of the error variance. Thus, each variable proved to be consistent with the measurement instruments. Convergent validity was evaluated by examining the standard loads on each construct (Chin, 1998). All measures were stated

as meeting more standard loads than the cut-off value of 0.500. The lowest was Co1 (0,538), and the highest was CL6 (0,946) (Table 3).

Table 3. Validity and Reliability

<i>Variables</i>	<i>Item</i>	<i>Outer Loading</i>	<i>CR</i>	<i>AVE</i>
Assurance	As1	0.806	0.884	0.603
	As2	0.766		
	As3	0.781		
	As4	0.747		
	As5	0.782		
Compliance	Co1	0.538	0.901	0.651
	Co2	0.832		
	Co3	0.813		
	Co4	0.907		
	Co5	0.889		
Empathy	Em1	0.854	0.899	0.642
	Em2	0.896		
	Em3	0.792		
	Em4	0.765		
	Em5	0.682		
Reliability	Re1	0.866	0.916	0.732
	Re2	0.913		
	Re3	0.847		
	Re4	0.792		
Responsiveness	Rs1	0.933	0.914	0.730
	Rs2	0.899		
	Rs3	0.882		
	Rs4	0.678		
Tangibility	Ta1	0.765	0.912	0.722
	Ta2	0.821		
	Ta3	0.907		
	Ta4	0.898		
Customer Loyalty	CL1	0.635	0.963	0.813
	CL2	0.893		
	CL3	0.917		
	CL4	0.916		
	CL5	0.945		
	CL6	0.946		

Discriminant validity was measured by analyzing the results of the cross-loading factor, as shown in Table 4. Cross-loading was assessed by comparing the factor loading value of an indicator with that of other latent variables. If the value is greater, the test is considered valid (Hair *et al.*, 2017). Therefore, each indicator correlates significantly with its latent variable and can prove satisfactory discriminant validity. The standardized loadings of the respective constructs are displayed to show the results of convergent validity testing (Chin,

1998). All measures of outer loading were above the cut-off value of 0.5. Thus, the criteria required for convergent validity were met.

Table 4. Cross loading

	As	CL	Co	Em	IFL	Re	Rs	Ta
As1	0,806	0,807	0,484	0,657	0,379	0,782	0,691	0,707
As2	0,766	0,541	0,190	0,493	0,479	0,514	0,486	0,522
As3	0,781	0,600	0,321	0,701	0,642	0,538	0,533	0,631
As4	0,747	0,415	0,553	0,676	0,410	0,579	0,508	0,535
As5	0,782	0,543	0,564	0,654	0,101	0,735	0,576	0,659
CL1	0,490	0,635	0,164	0,376	0,209	0,481	0,394	0,366
CL2	0,645	0,893	0,403	0,637	0,484	0,636	0,720	0,675
CL3	0,737	0,971	0,488	0,702	0,558	0,735	0,780	0,772
CL4	0,699	0,961	0,478	0,690	0,542	0,654	0,664	0,657
CL5	0,677	0,959	0,482	0,687	0,584	0,646	0,686	0,688
CL6	0,801	0,946	0,522	0,745	0,621	0,749	0,777	0,804
Co1	0,213	0,139	0,538	0,413	-0,133	0,117	0,129	0,154
Co2	0,409	0,336	0,832	0,589	0,181	0,410	0,530	0,544
Co3	0,348	0,411	0,813	0,461	0,434	0,382	0,536	0,488
Co4	0,546	0,385	0,907	0,568	0,361	0,588	0,470	0,445
Co5	0,627	0,579	0,889	0,659	0,223	0,666	0,571	0,544
Em1	0,792	0,637	0,524	0,854	0,455	0,717	0,662	0,824
Em2	0,801	0,700	0,588	0,896	0,533	0,680	0,654	0,796
Em3	0,468	0,486	0,576	0,792	0,199	0,488	0,543	0,570
Em4	0,484	0,563	0,675	0,765	0,162	0,578	0,570	0,551
Em5	0,711	0,481	0,333	0,682	0,381	0,518	0,497	0,631
FL	0,505	0,575	0,302	0,446	1,000	0,380	0,433	0,513
Re1	0,842	0,780	0,399	0,734	0,425	0,866	0,774	0,725
Re2	0,757	0,638	0,547	0,691	0,262	0,913	0,773	0,674
Re3	0,674	0,612	0,553	0,622	0,484	0,847	0,683	0,631
Re4	0,512	0,427	0,495	0,506	0,101	0,792	0,672	0,542
Rs1	0,698	0,741	0,603	0,721	0,453	0,802	0,933	0,850
Rs2	0,600	0,729	0,469	0,663	0,331	0,740	0,899	0,777
Rs3	0,663	0,636	0,619	0,610	0,451	0,788	0,882	0,721
Rs4	0,508	0,449	0,255	0,500	0,205	0,543	0,678	0,595
Ta1	0,527	0,556	0,575	0,653	0,280	0,560	0,702	0,765
Ta2	0,681	0,551	0,477	0,791	0,294	0,646	0,755	0,821
Ta3	0,789	0,735	0,390	0,725	0,607	0,695	0,724	0,907
Ta4	0,686	0,701	0,496	0,725	0,543	0,662	0,766	0,898

Note: As = Assurance; CL = Customer Loyalty; Co = Compliance; Em = Empathy; FL = Islamic Financial Literacy; Re = Reliability; Rs = Responsiveness; Ta = Tangibility

Structural Model Analysis

All the variables used a five-point Likert scale, including Islamic financial literacy. The estimation results to prove the developed hypothesis, as well as the outputs of the outer and inner models, are shown in Figure 2.

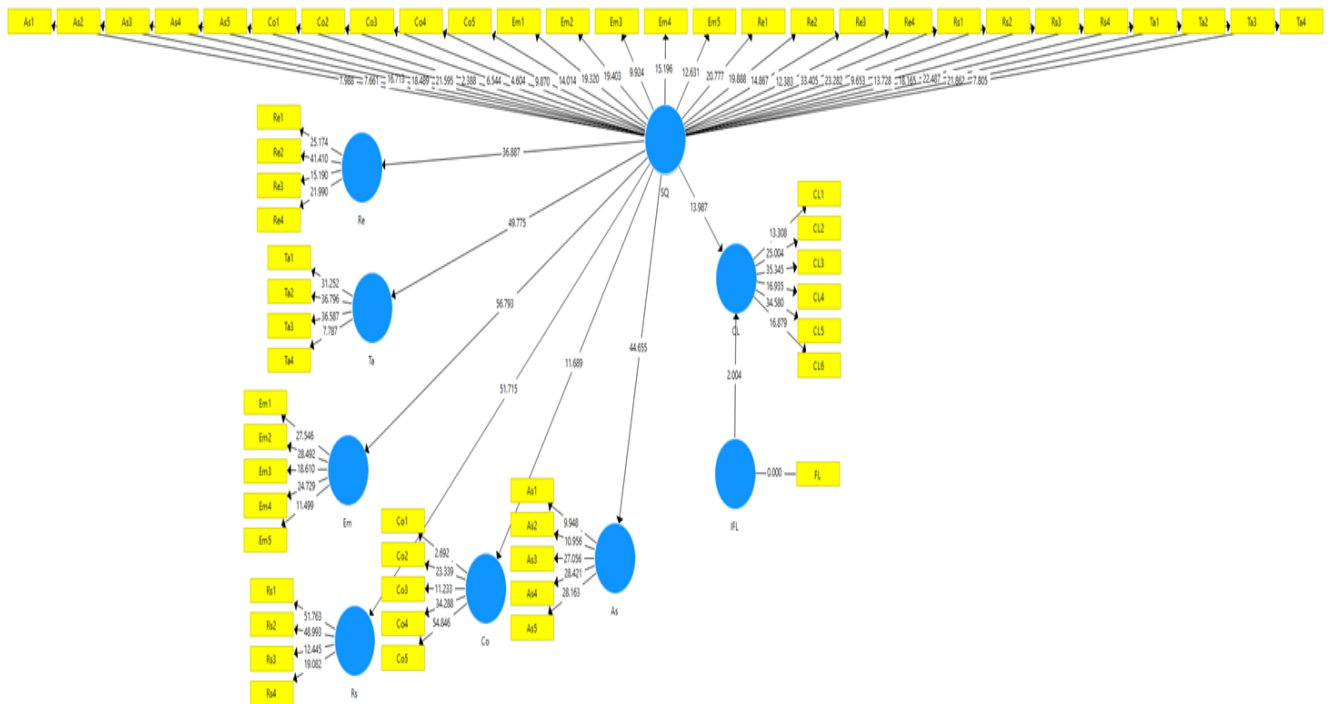


Figure 2. Path Model

Islamic financial literacy influence on customer loyalty

The second construct examines the effect of Islamic financial literacy (IFL) and Service Quality (SQ) on customer loyalty (CL). Table 5 presents the results of significance tests for each variable. This study applied a significance level of 0.05, indicating 5% error tolerance when proving the hypothesis. As shown in Table 5, Islamic financial literacy has a significant and positive influence on customer loyalty (IFL → CL, $\beta = 0.145$, $p = 0.046$). Thus, Hypothesis 1 was confirmed.

Table 5. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
IFL -> CL	0,145	0,145	0,072	2,004	0,046
SQ -> CL	0,775	0,778	0,055	13,987	0,000
SQ -> As	0,919	0,917	0,021	44,655	0,000
SQ -> Co	0,729	0,731	0,062	11,689	0,000
SQ -> Em	0,929	0,929	0,016	56,793	0,000
SQ -> Re	0,908	0,911	0,025	36,887	0,000
SQ -> Rs	0,924	0,923	0,018	51,715	0,000
SQ -> Ta	0,929	0,929	0,019	49,775	0,000

Note: As = Assurance; CL = Customer Loyalty; Co = Compliance; Em = Empathy; FL = Islamic Financial Literacy; Re = Reliability; Rs = Responsiveness; Ta = Tangibility; SQ = Service Quality

Compliance, assurance, responsiveness, tangibility, empathy, and reliability as the sub-dimensions of service quality

According to the result of hypothesis testing, all dimensions of service quality is significantly

associated with service quality because the p value is not greater than 0.05 (SQ \rightarrow As, $\beta = 0.919$, $p = 0.000$; SQ \rightarrow Co, $\beta = 0.729$, $p = 0.000$; SQ \rightarrow Em, $\beta = 0.929$, $p = 0.000$; SQ \rightarrow Re, $\beta = 0.908$, $p = 0.000$; SQ \rightarrow Rs, $\beta = 0.924$, $p = 0.000$; SQ \rightarrow Ta, $\beta = 0.929$, $p = 0.000$). Thus, Hypothesis 2 was also accepted.

Service quality influence on customer loyalty.

The service quality dimensions were confirmed to be significant. Next, we test the effect of service quality on customer loyalty. The results show that service quality has a significant impact and is positively related to customer loyalty (SQ \rightarrow CL; $\beta = 0.775$). Therefore, Hypothesis 3 is supported.

Table 6 shows that the R² value of the endogenous variable is 0.683. This simply means that 68.3% of customer loyalty is explained by exogenous variables, while other attributes evaluate the remaining 32.7%. VIF aims to determine whether multicollinearity is found in the structural model.

Table 6. R Square Value

	R Square	R Square Adjusted
CL	0,683	0,660

Note: CL = Customer Loyalty

Table 7 shows that the value for each exogenous variable is less than ten, thereby indicating that they are free from collinearity problems. According to (J.F Hair *et al.*, 1995), VIF values less than ten are acceptable and are obtained using the SmartPLS calculation.

Table 7. Inner VIF value

Exogenous Latent Variable	Variance Inflation Factor (VIF)
IFL	1,318
SQ	1,318

Note: CL = Customer Loyalty; SQ = Service Quality

Discussion

This study discusses the impact of service quality and Islamic financial literacy on customer loyalty in the Islamic Regional Bank of Indonesia. This study is also expected to obtain information on specific dimensions to improve service quality in Islamic regional banks, including compliance, assurance, responsiveness, tangibility, empathy, and reliability. The research findings are also expected to validate the model and previous research conducted by Amin and Isa (2008), Alshurideh *et al.* (2017), and Asnawi *et al.* (2020).

Islamic financial literacy influence on customer loyalty

Islamic financial literacy has emerged as a crucial determinant of customer loyalty, as evidenced by the positive and significant coefficient of 0.145. This finding underscores the pivotal role of knowledge and understanding of Islamic financial principles in fostering loyalty among customers of Islamic banks. Although no similar studies have been conducted, these results support the research (Austin & Arnott-Hill, 2014). According to research,

financial literacy is essential for making optimal decisions concerning funds, leading to the realization of loyal Islamic bank customers. This finding supports the research conducted by Firmansyah et al. (2020) that shows that respondents gain knowledge and familiarity with Islamic rural banks while attending college, influencing their choice of Islamic rural banking. By enhancing their understanding of Islamic finance, customers become better equipped to navigate the intricacies of Islamic banking products and services, ultimately fostering loyalty to Islamic banks. However, this result contradicts the research conducted by (Albaity and Rahman, 2019), who stated that it hurts customer loyalty. This result tends to have a positive effect when mediated by attitude towards Islamic banking. This implies that customers with a strong foundation of Islamic financial literacy may exhibit higher levels of loyalty when they have positive attitudes towards Islamic banking practices.

These findings have significant implications for Islamic regional banks, highlighting the importance of investing in initiatives to improve customers' financial literacy by ensuring they understand transaction processes, offer financial advice, and support and facilitate Islamic educational institutions. Banks can empower customers to make informed financial decisions by providing educational resources, offering financial advice tailored to Islamic principles, and supporting Islamic educational institutions. Moreover, fostering positive attitudes towards Islamic banking can strengthen the link between financial literacy and customer loyalty, ultimately contributing to Islamic banks' long-term sustainability and success in a competitive financial landscape.

Compliance, assurance, responsiveness, tangibility, empathy, and reliability as the sub-dimensions of service quality

The object of this study is an Islamic regional bank in West Nusa Tenggara, Indonesia. The research findings are expected to explain whether there are differences in customer service quality perceptions between Islamic regional banks and Islamic commercial banks, as carried out by Asnawi et al. (2020).

The results of this study show that compliance, assurance, responsiveness, tangibility, empathy, and reliability are dimensions of service quality for Islamic regional banks in Indonesia. This finding strengthens the findings of Amin and Isa (2008), namely that SERVQUAL plus Shariah compliance is a service quality dimension for Islamic commercial banks in Malaysia, and Alshurideh et al. (2017), who found that tangibility, reliability, empathy, assurance, and responsiveness are dimensions of service quality in Islamic commercial banks in Jordan.

The research findings also strengthen those of Asnawi et al. (2020) that Islamic values, Shariah compliance, honesty, modesty, humaneness, and trustworthiness are service quality dimensions in Indonesian Islamic commercial banks. The service quality dimension developed by Asnawi et al. (2020) does not refer directly to the CARTER concept used in this study. However, the dimensions of Islamic value, Shariah compliance, honesty, modesty, humaneness, and trustworthiness align with those developed in this study. The above analysis results show that compliance, assurance, responsiveness, tangibility, empathy, and reliability are the correct dimensions of service quality for both Islamic Commercial banks and Islamic regional banks in Indonesia.

These findings have significant implications for regional and commercial Islamic banks in Indonesia. By recognizing and prioritizing these service quality dimensions, banks can better understand and meet the needs and expectations of their customers. Moreover, the consistency of these dimensions across different studies suggests the possibility of

developing standardized measures. It benchmarks for evaluating service quality in Islamic banking, facilitating comparability, and benchmarking across institutions. Overall, the findings underscore the importance of aligning service delivery with Islamic principles and customer expectations to enhance customer satisfaction and loyalty and the competitiveness and sustainability of Islamic banking institutions in Indonesia (Fadilah & Mulazid, 2018). This more profound understanding of the service quality dimensions provides actionable insights for banks to improve their service offerings, strengthen their market positions, and contribute to the growth and development of the Islamic finance industry in the region.

Service quality influence on customer loyalty.

Service quality significantly affects customer loyalty, with an estimated positive coefficient of 0.775. This finding is consistent with (Butt & Aftab, 2013) and (Minh & Huu, 2016) regarding the mediating effect of customer satisfaction. Ou et al., (2011) stated that service quality positively impacts commitment, which affects customer loyalty. Therefore, Islamic regional banks need to improve services rendered in fulfilling Sharia policies, professional employee attitudes, safe and accurate transactions, attending to customers individually, a clean and comfortable environment, availability of ATM and Internet banking, and the availability of other services branches for easy accessibility.

These findings have important implications for regional Islamic banking. Banks should prioritize and continuously improve their service quality across multiple dimensions. Islamic regional banks should focus on fulfilling Shari'ah guidelines, maintaining professional staff attitudes, ensuring secure and accurate transactions, providing personalized attention to customers, maintaining a clean and comfortable banking environment, improving the accessibility of banking services through ATM and Internet banking facilities, and the availability of branch services. By focusing on these critical aspects of service quality, Islamic regional banks can increase customer satisfaction, foster more muscular customer retention, and ultimately foster greater loyalty within their customer bases.

Moreover, the implications of these findings extend beyond the individual bank level to the broader Islamic financial industry. As Islamic banking continues to grow and expand globally, the importance of service quality in driving customer loyalty becomes increasingly apparent (Setyadi et al., 2023). By prioritizing service excellence and aligning service delivery with Islamic principles and customer expectations, Islamic regional banks can strengthen their competitive positions and contribute to the overall growth and development of the Islamic finance industry.

4. Conclusion

Islamic financial literacy influence on customer loyalty

In conclusion, this study establishes a significant and positive relationship between Islamic financial literacy and customer loyalty, highlighting the importance of customer knowledge in Islamic finance for fostering loyalty to Islamic regional banks. These findings underscore the need for banks to prioritize strategies aimed at enhancing customers' understanding of Islamic finance, ultimately promoting loyalty to and preference for Islamic banking services. Therefore, the higher customers' level of literacy in terms of Islamic finance, the greater their loyalty to regional Islamic banks. Banks must develop strategies that support or facilitate Islamic financial and educational institutions to boost customer knowledge of Islamic finance. This was achieved by introducing Islamic banking to new customers when

opening accounts, with the help of frontliners.

Compliance, assurance, responsiveness, tangibility, empathy, and reliability as the sub-dimensions of service quality

Service Quality has a significantly positive effect on customer loyalty. Furthermore, this study identifies compliance, assurance, responsiveness, tangibility, empathy, and reliability as the critical service quality dimensions for Islamic regional banks in Indonesia. Empathy and tangibility emerged as the most influential dimensions, emphasizing the importance of personalized customer interactions and tangible service elements in driving customer loyalty..

Service quality influence on customer loyalty.

Customers' perceptions of Islamic regional banks' service quality made them more loyal. These financial institutes must also apply the service quality dimension by implementing Islamic principles integrated into Sharia compliance. Furthermore, Islamic regional banks must display the emotional branding aspect by paying attention to customers individually and having a better understanding of their needs.

These findings have significant implications for Islamic regional banks, emphasizing the importance of integrating Islamic principles into service delivery and prioritizing customer-centric approaches. By aligning service quality dimensions with Islamic values and meeting customers' unique needs, banks can foster stronger emotional connections and loyalty, ultimately driving long-term success and sustainability in the Islamic finance industry.

Managerial Implications

The findings show that service quality significantly affects the loyalty of Islamic regional bank customers. Therefore, regional Islamic banks must improve service quality to increase customer loyalty. Among all dimensions of service quality, the most dominant influence was empathy and tangibility. Thus, Islamic regional banks need to improve the facilities owned by Islamic regional banks, the appearance of front-liners, environmental cleanliness, understanding of customer needs, demonstrate a friendly and professional attitude and improve e-banking performance by minimizing errors and adding more useful features.

Recommendations

The findings offer an opportunity to develop novel theories and models to elucidate the relationship between Islamic financial literacy and customer loyalty. This constitutes a significant contribution to the academic literature. Furthermore, the outcomes of this study provide invaluable guidance for Islamic banks seeking to elevate their customers' financial literacy to increase loyalty. This, in turn, can assist Islamic banks in designing more effective financial education programs. This study provides practical insights into Sharia banking, considering the nuances of financial literacy..

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