THE MEDIATION EFFECT OF CUSTOMER SATISFACTION ON SERVICE QUALITY – CUSTOMER LOYALTY LINK IN INSURANCE SECTOR OF ETHIOPIA– A STUDY

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ABSTRACT

Although Ethiopia has huge population base and untapped insurance market the industry faced a challenge of high customer churn rate. Customers are lapsed increaseingly from the existing providers in which the defect customer damaged the company by spreading company bad experience to others and decreaseing income of the company as they may not renewal one or two or three of the policies. So, insurers need to cement their relationship to customers by meeting their needs inorder to retain them in the company. Insurers in order to survive and prosper they should have to find ways to retain their current customers by concentrating on different factors which enhances customer loyalty

 Thus, this **study aims at** to analyze the direct and mediating influence of service quality on customer loyalty in the insurance sector of Ethiopia. In order to achieve this objective, **the research methodology** designed for this study is non –experimental (descriptive –analytical) in nature and the method used in this thesis is quantitative study. Thus, to elicit policyholders attitude, questionnaires are designed, and then based on the data gained from respondents' the analysis is done and results are explained. Pearson correlation and regression analysis were used to examine the relationship between service quality, customer satisfaction, and customer loyalty in SPSS 16.0 and Amos soft wares.

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The **results of the study** indicate that service quality and customer satisfaction; have direct and positive relationship to customer loyalty. Service quality influences customer loyalty directly and it can also affect directly customer satisfaction and it is also found that customer satisfaction has mediating effect on the relationships between service quality and customer loyalty link.

1. Introduction

Insurers need large number of policyholders for their survival and prosperity. It is obvious that if customers do not get quality service and become dissatisfied by the provider, they undoubtedly will go elsewhere. As in any other sectors, it produces a market share loss for the firm. Even though this effect can be compensated by new customers, in the insurance firm the composition and quality of insurance risks are severely distorted when contracts are massively cancelled and this has a negative impact on the solvency of the company. For this reason, increasing customer loyalty has become necessary for the insurance company. The key to success is to make customer feel so satisfied that they will remain for long (Smith 2002).

The business environment severe competition and development of information technology have enhanced insurers' awareness and created a situation where long-term success can be achieved by building customer loyalty. Quality service offered to policyholders make customers to be satisfy and this leads to loyalty which is increases company revenue (Roger et al, 2011). The more insurers offered quality service for policyholders the more customers will satisfy which reinforce their loyalty for the company. Understanding the nature of relationships between service quality, customer satisfaction and customer loyalty may provide creative ideas for improving customer loyalty in order to gain a competitive advantage in the insurance companies of Ethiopia. Thus, this study made efforts to know the direct and mediating influence of service quality on customer loyalty and so that the study is organized consecutively in order to achieve this objective.

2. Purposes of the study

2.1. Statement of the problem

Despite of the favorable condition for insurance development in Ethiopia, customer defections are high in the insurance sector. Interview with Nile insurance marketing director shows from **25,840 policyholders 3,997 (15%) did not renewal their policies in 2010/11.** According to Ethiopian Insurance Corporation business development and risk management department

director interview response, from the total of (general and life) 69,731 policies 17, 884(25.6%) policies were not renewed in 2011. This shows that customer retention becomes a challenge for Ethiopia insurers.

A leaving customer may damage a company into two ways: loss of business from that customer and negative word- of – mouth leading to the loss of business. The longer a customer stays with a company, the more that company is worth. Long term customers can purchase other policies more; take less of a company's time. Thus, insurance companies should make great efforts to retain customers and make them loyal to the company for their survival and prosperity. According to Jacada (2008) & American satisfaction index (26%) of insurance customers switch insurance providers, based solely on a bad experience with the company. Quality service offered to customers makes them to be satisfied that enhance their loyalty for the company. Johnson & Gustafsson(2006) revealed that service quality is linked to loyalty directly and indirectly. This means quality service offered to customers can affect loyalty in two ways: directly service quality – loyalty relationship and indirectly through customer satisfaction to loyalty

Thus, it will be essential to examine the relationship between service quality to loyalty directly and indirectly. Therefore, considering the challenge of customer lapsing, this study is aimed at to analyze the mediation effect of customer satisfaction on service quality – loyalty link in order to maintain customers loyal to the company. It is believed that the result of the study enables insurers mobilizing resources in order to create loyal customers in their respective companies.

2.2 Objective of the Study

The objective of the study is to analyze the direct and indirect influence of service quality on customer loyalty. Specifically, the study examines the mediation effects of customer satisfaction on service quality and customer loyalty relationships.

2.3 Research hypotheses

The following Null hypotheses act as a framework to guide the current research

Ho1: There is no significant relationship between service quality and customer satisfaction

Ho2: There is no significant relationship between service quality and customer loyalty

Ho3: There is no significant relationship between customer satisfaction and customer loyalty

Ho4: There is no significant mediating effect of customer satisfaction between service quality and customer loyalty link.

3. Scope and limitation of the study

The scope of the study covers insurance companies suited in Addis Ababa, capital city of Ethiopia .The study is also limited to policyholders of the insurance companies located in Addis Ababa as respondents. The study is embodied with some limitations.

1. The study does not assess all antecedents of customer loyalty but only addresses specific antecedents to customer loyalty; service quality, customer satisfaction.

2. The may be additional mediation variables that contribute to influence customer loyalty. There are suggestions that demographic factors play mediator role, customer trust mediates between service quality and loyalty. However, this study considers customer satisfaction as mediation between service quality and loyalty.

3. Data were gathered from only one place, Addis Ababa capital city of Ethiopia. Customers' attitudes might not be generalizable to other regional states of Ethiopia

4: Review of Literatures

Nowadays, customer loyalty has received much consideration and attention in the business environment. Companies give emphasis to retain their customers in order to survive or prosper in today's volatile competitive business environment. Heskett et al (1994) defined customer loyalty as: Customer loyalty represents the repeat purchase, and referring the company products to other people.

Loyal customers have direct impact on company's profitability.   "When a company consistently delivers superior value and wins customer loyalty, market share and revenues go up, and the cost of acquiring and serving customers goes down" (Rechheld 1993, p. 64). This means market share and revenues increase as a result of loyal customers who make repeat purchases and make referrals. The company's costs also decrease because less money is spent trying to lure in new customers. Reichheld & Sasser's (1990 as cited in Roger et al 2011 p.138) study showed that even a small increase in customer retention rates could have a major impact on profitability. Moreover, Roger et al ,(2011) developed the "customer –company profit chain" as: Service quality leads to customer satisfaction and customer satisfaction leads to customer loyalty which leads to company profitability. Johnson & Gustafsson(2006) revealed a bit contrasting view that service quality is linked to loyalty directly and indirectly. This means   quality service offered to

customers can affect loyalty in two ways: directly service quality – loyalty and indirectly through customer satisfaction to loyalty

Similarly, Kumar and W.J. Reinartz(as cited in Roger et al., 2008 p.136)claim that the link between customer satisfaction and customer loyalty is asymmetric (dissatisfaction has a greater impact on loyalty than satisfaction). Roger et al., (2011, p.130) pointed out that dissatisfied customers tell more people about their bad experience than satisfied customers with good experiences. Moreover, some researchers point out that customer satisfaction played a mediation role between service quality and customer loyalty link. A mediator variable is one that explains the relationship between the two other variables (Baron, & Kenny, 1986). The figure below illustrates three types of mediation relationships.
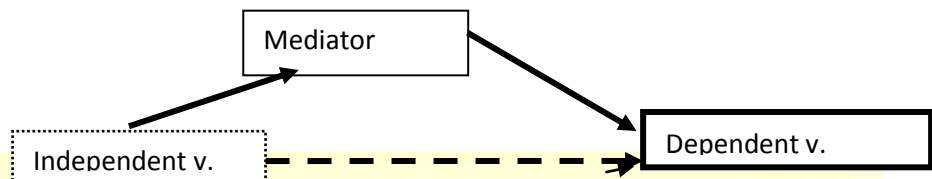
1. Indirect effect
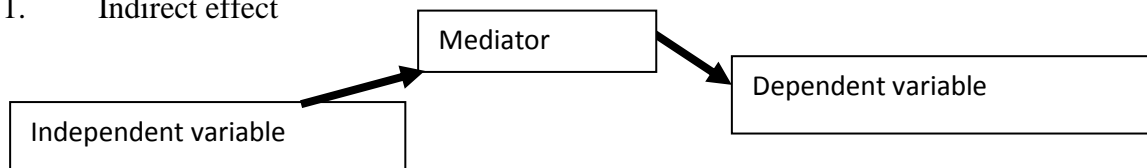
The independent variable affects the mediator and the mediator affects the dependent variable. IV does not affect DV directly.

Partial mediation
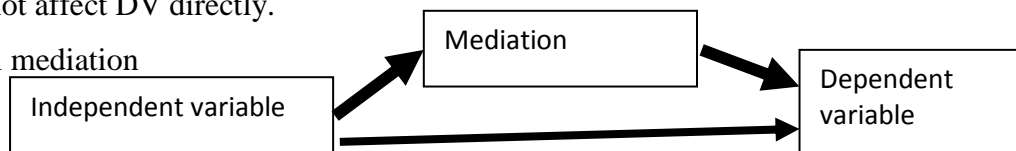
The independent variable affects the dependent variable, and also the dependent variable related to mediation variable. In turn the mediation variable influences the dependent variable.

Full mediation

Independent variable affect directly the mediator, the mediator in turn affect the dependent variable. The effect of independent variable to the dependent variable is insignificant.

Figure 1: Types of mediation (adapted from Baron & Kenny 1986)

Baron and Kenny (1986) asserted that the evidence for mediation is strongest when there are both indirect and direct effects; they call it "partial mediation." In the literature review above it is explained that service quality directly affects customer loyalty. And again service quality

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affects customer satisfaction and customer satisfaction influences customer loyalty. Therefore, three conditions are met for partial mediation to be exist as showed in figure above.

Drawing on the above-mentioned literature and theoretical reviews the following theoretical model guiding the investigation is depicted in figure below.
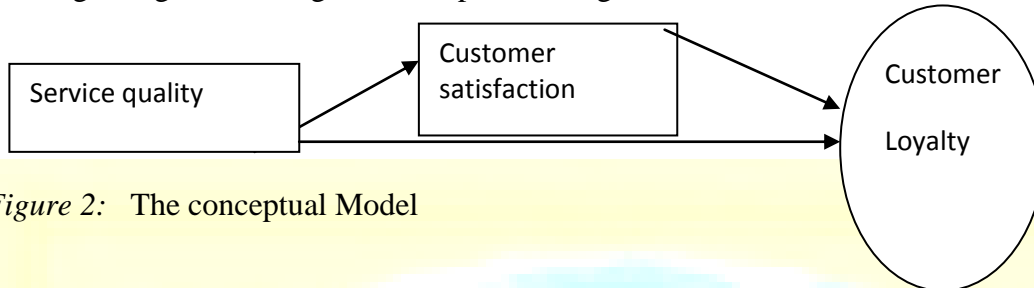

Figure 2: The conceptual Model

5. Methodology

The study aims at to understand the direct and mediating influence of service quality on customer loyalty. Thus, this study is *a single cross –sectional* descriptive study used to obtain a picture of policyholders' opinions of their status of loyalty to their respective insurance companies. The survey was carried out in a natural field conditions and data collected pertaining to respondents' attitudes and perceptions. Sources of data are described below.

Source of Data

The data for this survey are derived from primary and secondary sources.

Information elicitation instruments	Descriptions
Primary: Questionnaires	Structure questionnaires which distributed to respondents and collected by enumerates
Secondary: Literature study (internet and hard copy) & a archival records	Books (Statistics, Marketing and insurance books) Journals (publications of individual, governmental & non-governmental),Previous research works, Reports (Annual reports, quarterly reports), Insurance companies financial, performance, policyholders records,

Questionnaires Design

The data collection instrument designed for this study is structured questionnaire adapted from previous researches used for collecting information about people's beliefs, attitudes, and behavior and designed for self-administered by the respondents in that to elicit genuine information. The questions are designed in a manner so as to glean the maximum information from the

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respondents and taking minimum of their time..The survey items are statements on which respondents will be asked to indicate the extent of their agreement or disagreement, using five points, Likert-scale items.

Sample Design

Insurance business operates all over the country and it is overwhelming to conduct attitude survey of all policyholders in the country .Thus, the study of attitude survey focused on policyholders who get insurance service in Addis Ababa , capital city of Ethiopia. Based on insurance companies licensed business area three companies from each category (Nonlife, Life & Composite) using probability approach of simple random sampling were taken sample of the study. Therefore, Nile, Global & Ethio-life insurance companies were selected by using simple random sampling approach and for this study in which its respondents are heterogeneous **stratified random sampling** –proportionate is applied.

The policyholders' attitude & perception survey sample size is based on Nargundkar (2010) formula for sample size calculation so that the sample size required for the survey is 1,110. The questionnaires are distributed to 1,110 respondents according to the short-list by enumerates and collected by enumerates but only 1000 questionnaires were found fit (90%) and taken for analysis. Respondents were assured of complete anonymity and confidentiality of responses .The respondents also told their participation is purely voluntary.

Test for internal consistency of data

Table 1. *Rule of Thumb for Cronbach Alpha*

Rate	standard	Rate	Standard	Rate	Standard
≥ 0.9	Excellent	≥ 0.7	Acceptable	≥ 0.5	poor
≥ 0.8	Good	≥ 0.6	Questionable	< 0.5	Unacceptable

Source: Georg and Mallery as cited in Prabhakar (2006:6)

The table below shows reliability statistics of: service quality, customer satisfaction, and customer loyalty.

Table 2: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.910	.922	3

Cronbach's alpha employs the covariances among the items, whereas the alpha based on standardized items employs the correlations among items. The latter alpha is based on the assumption that all of the items have equal variances, which is often false in practice (IBM. nd) . The reliability was reported as above the standard of .70 and can be considered a good scale. Hence, there is no need to drop any items.

Statistical treatment used in data analysis

In the process of converting data into useful information different types of analysis were employed as the bivariate Pearson correlation and linear regression using SPSS 16.0 and mainly mediation analysis using Amos 5.0 software were applied to test the mediation effect in a single analysis.

6. Data analysis and interpretation

6.1 Relationships: Correlation analysis

Pearson correlation analysis is conducted to know if there is a relationship between variables.
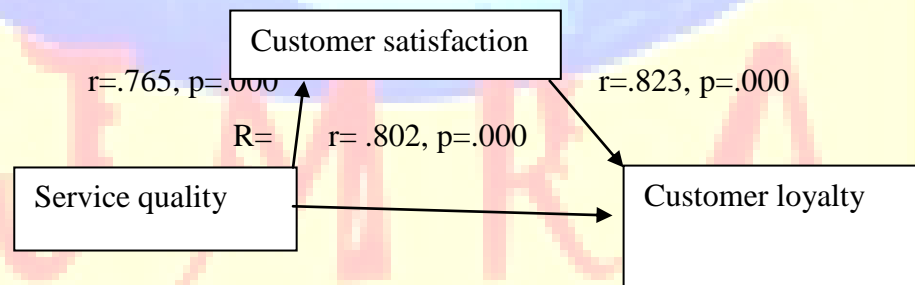
Findings of correlation analysis and inference

- *Significance Level: α = 0.01, that is the chance of occurring type I error is 1 %.*

- *Critical Value and Rejection Region: Reject the null hypothesis if p-value ≤ 0.01.*

Pearson correlation test shows that service quality and customer satisfaction (r=.765, p value is less than .01). The correlation between customer satisfaction and customer loyalty (r=.823, p value is less than .01) and the correlation between service quality and customer loyalty (r=.802, p value is less than .01). Correlation value greater than .7 is considered as strong and also the probability value is equal to zero so that the correlation between the two variables is significant,

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Null hypothesis is rejected. The estimated correlation indicates that there is **strong and positive** correlation between variables. The variables **move in the same direction together**. This means higher scores on one variable tend to be paired with higher scores on the other. A change in one variable corresponds a change in customer loyalty.

6.2. Mediation analysis

6.2.1. Regression analysis: Service quality, customer satisfaction & customer loyalty

.Baron and Kenny (1986) addressed the steps required for mediation test:

1).The total effect of the independent variable on the dependent variable must be significant (X → Y)

2) The path from the independent variable to the mediator must be significant (X → M

(3) The path from the mediator to the dependent variable must be significant (M (and X) → Y).

 The pictorial representation below makes it more understandable

 Figure 3: Mediation, direct & total effect of variables adapted from Baron and Kenny (1986).

Thus, the following three regression models are performed:

1. The effect of independent variable (service quality) on mediator variable regression (customer satisfaction): in this test, satisfaction will be considered as dependent variable, and service quality as independent variable.

2.   The effect of independent variable (service quality) regression on dependent variable (customer loyalty): In this test, loyalty will be considered as dependent variable, and service quality as independent variable

3. The effect of independent variable (customer satisfaction) regression on dependent variable (customer loyalty): in this test, loyalty is considered as dependent variable, and service quality and satisfaction as independent variable.

Table 3: *Regression Equation Results; between Service Quality, Customer Satisfaction and Customer loyalty. (α=.05, two tailed)*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate

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1.Effects of service quality on customer satisfaction	.765	.585	.584	.3886
2.Effects of service quality perception on customer loyalty	.802	.643	.643	.4376
3 Effect of satisfaction on customer loyalty	.823	.678	.677	.4158

As shown in the table above, for the first model, R² = 0.585 was obtained, and it can be said that 58.5 percent of the dependent variable changes is explained by the model. In the second model, number, R² = 0.643, thus almost 64.3 percent of the dependent variable changes is shown by the model. As shown, R² = 0.678 was obtained in the third model, and it can be considered that 67.8 percent of the dependent variable changes is explained by the model, in other words, a very high percentage of dependent variable changes are identified by the mentioned model. As a result, customer satisfaction partially mediates the relationship between services quality and customer loyalty.

Table 4: Mediation Result in Bootstrapping Using Amos 5.0

		Estimate	S.E.	C.R.	P
Satisfaction <---	Service quality perception	.935	.025	37.501	***
Loyalty <---	Customer satisfaction	.614	.030	20.563	***
Loyalty <--	Service quality perception	.617	.037	16.884	***

As the regression weight shows when service quality goes up by 1, customer satisfaction is also increase by .935. The critical ratio (C.R) for regression weight can be obtained by dividing the regression estimate by the estimate of its standard errors as: Z= .935/.025= 37.501. Which means the regression weight estimate is 37.501, standard error above zero. The regression weight for service quality in the prediction of customer satisfaction is significantly different from zero at the .001level.

In the same way, when customer satisfaction goes up by 1. Customer loyalty goes by .614. The regression weight for customer satisfaction in the prediction of customer loyalty is significantly different from zero at the .001level. When service quality goes up by1, customer loyalty goes by .617. The regression weight for service quality in the prediction of customer loyalty is significantly different from zero at the .001level.

The test verified that service quality affects customer satisfaction and customer loyalty, and also customer satisfaction affects customer loyalty. Furthermore, the study utilizes the Baron and

Kenny (1986) structural equation modeling technique to assess the mediating effects of service quality on customer loyalty .Baron and Kenney's (1984) procedure stipulates that four conditions must be upheld for partial mediation. The first condition is that an independent variable (as service quality) must directly affect the mediator (as Customer satisfaction).   For the second condition, the mediator (Customer satisfaction) must affect the dependent variable (customer loyalty).   Figure 4 below demonstrates the fulfillment of the first two conditions. The third condition is satisfied when the service quality directly affects customer loyalty once the mediator is removed from the model. All paths from service quality perception to customer loyalty as mediated through customer satisfaction have been examined.
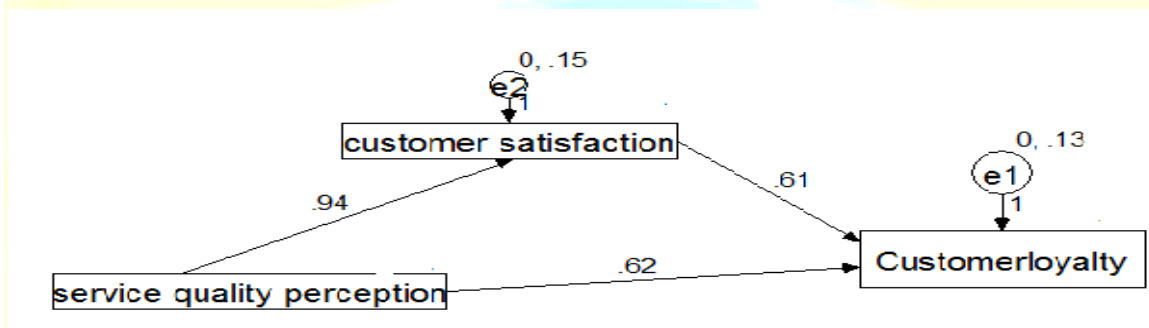

Figure.4: *The mediation & direct effect of service quality on customer loyalty*

The figure above shows the direct and indirect effect of service quality on customer loyalty. The overall effects are summarized in the table below.   The table below shows that the results of measurement models to test the hypothesis with regard to model paths. The model has examined the relation of   service quality and customer loyalty through customer satisfaction as mediation using Amos software.

Table 5: Total, Direct and Indirect Effect of Service Quality on Customer loyalty

	Total effect		Direct effect		mediated effect	
	service quality	customer satisfaction	service quality p	customer satisfaction	service quality	customer satisfaction
customer satisfaction	.935	.000	.935	.000	.000	.000
Customer loyalty	1.191	.614	.617	.614	.574	.000

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Total effect: The total, direct and indirect (mediated) effect of service quality on customer satisfaction is .935. That is due to both direct (unmediated) effects of service quality on customer satisfaction, when service quality goes by 1 customer satisfaction goes up by .935.

Direct Effect: The direct effect of service quality on customer satisfaction is .935. That is due to the direct (unmediated) effects of service quality on customer satisfaction, when service quality goes by 1 customer satisfaction goes up by .935.This is in addition to any indirect effect that service quality may have on customer satisfaction. The direct effect of SQ on customer loyalty is .617. That is due to the direct effect of SQ on customer loyalty, when SQ goes up by 1, customer loyalty goes up by .617.

The indirect effect of service quality perception on customer loyalty is .574. That is due to the indirect effects of SQ on customer loyalty. When SQ goes up by 1, customer loyalty goes up by .574. This is in addition to any direct effect that service quality may have on customer loyalty.

6.2.2 Findings of mediation analysis and inference

The findings shows that Service quality affects customer satisfaction (Regression weight =.935, p<.001). This is statistically significant. Customer satisfaction in turn affects customer loyalty directly (Regression weight=.614, P<.001).This is statistically significant. And then service quality affects customer loyalty directly (Regression weight=617, P <.oo1).Which is statistically significant. Also service quality affects customer loyalty indirectly (Regression weight=.574, p<.001.Which is statistically significant. Hence Null hypothesis is rejected and alternative hypothesis is accepted. The results of the test of hypothesis revealed service quality has a direct, positive effect on customer satisfaction, and also customer satisfaction affects customer loyalty. Service quality affects customer loyalty directly and indirectly.

Similarly, Jones and Sasser (1995) found that an increase in customer satisfaction produces a stronger effect on loyalty. Besides, Ernst &Young (2012) in the Global insurance survey found that satisfaction with the provider drives higher repeat purchases

The findings indicate that while service quality is an important driver of customer loyalty, its direct effect is larger than the indirect effect in generating higher customer loyalty. It is important for the insurers to focus on service quality dimensions and make efforts to create satisfaction and among customers. Insurers need to develop a systematic assessment programs to monitor service quality, customer satisfaction and customer trust overtime. Company employees should be kept informed of results and be encouraged to take part in figuring out an effective resolution strategy.

7.Findings, suggestions and conclusion

The focus area in this study was to examine the direct and indirect influence of service quality on customer loyalty i.e.mediation effects of customer satisfaction on service quality –loyalty link. It was hypothesized that there is no significant relation between variables. The relationships between service quality, customer satisfaction and loyalty were tested through Pearson correlation . The Pearson correlation test result shows that relationship between service quality, customer satisfaction, & and customer loyalty is positive, strong and significant at the 0.01 level 2-tailed .This means the increment   in one variable would correspond to increase in customer loyalty. Such direct relationship between variables is a message for insurers calling for attention if they want to build customer loyalty.

The **mediation** analysis suggests that customer satisfaction plays the role of mediation between service quality and customer loyalty link. The total effect of service quality on customer loyalty is 1.191 in which its direct regression effect on customer loyalty is .617 and its mediation regression effect is .574. Customer satisfaction is affected by service quality directly by regression weight of .935 and customer satisfaction affects customer loyalty by regression weight of .614 .The effect size tell us how much of the effect of the service quality   on the customer loyalty can be attributed to the indirect path of (service quality—customer satisfaction—customer loyalty). The direct effect is the size of the correlation between the service quality and the customer loyalty with the mediating variable included in the regression.

  Hence the statistical significance test of mediation suggests that customer satisfaction is significantly mediating between service quality and customer loyalty link .The effect of service quality on satisfaction is positive and significant. The value of path coefficient is 0.935 while the indirect effect of service quality on customer loyalty is .614 but lower than the path between service quality and customer satisfaction.

The problem of customer lapsing in insurance sector of Ethiopian is a severe problem that makes to the decline of premium & low insurance distribution which initiated me to launch this study. The study was aiming at to investigate the mediation effect of customer satisfaction on service quality –loyalty link. Thus, for the attitude survey, data collected and analyzed with the help of appropriate statistical tools for further interpretation. Hence, the following conclusions have been drawn from the findings of the study.

Providing quality service for policyholders and make them satisfied that could create twofold advantages for insurers: policyholders could urge more people to join insurance companies. Their role of playing as company advocacy could accelerate in accordance to insurers' offering quality service. The more customers get quality service the more they abide with the provider. The more they are treated, the more they satisfy with the company, the more they get prompt service they could build faith on the company and extend company products to others and could make repeat purchase. Retention pays better than acquisition; customer acquisition is five to ten times more expensive than customer retention (Bhattacharijee, 2006).

Poor service encourages switching while delivering an efficient service will validate a policyholder's view that they have chosen the right insurer. If providers unable to respond to customer changing needs, they will switch to other providers. Therefore, insurers need to cement their relationship with their customers by improving the service they provide to meet customer needs, develop and employ strategies to satisfy customers. Getting the service right will improve customer satisfaction and assist in the building of customer loyalty because service quality and customer satisfaction contribute for creating a loyal customer base.

Thus, it is important for the insurers to focus on service quality dimensions and make efforts to create satisfaction among customers. Service quality is an important antecedent of customer satisfaction and customer loyalty. Hence, insurers should focus on customer satisfaction for which service quality is an important antecedent. The impact of service quality on customer satisfaction is considerably strong and can lead to a more favorable towards loyalty.

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