Impact of Perceived Service Quality on Customer Loyalty in Restaurant Industry of Birendranagar, Surkhet: Mediating Role of Customer Satisfaction and Word-of-Mouth

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Abstract

This study is about restaurant industry of Birendranagar Surkhet. The purpose of this study is to see how perceived service quality influences the customer loyalty directly and indirectly through customer satisfaction and positive word-of-mouth. Because of changing customer behavior, influence regarding social media and exposure to outer world competition has intensified in all business including hospitality sector. There are four constructs: perceived product quality, customer satisfaction positive word-of-mouth and customer fidelity in this research. Structured questionnaire was designed focusing on four construct to collect primary data from restaurant customers. The study employs quantitative analysis techniques, including structural equation modeling, to examine the relationships among constructs.
The findings are expected to reveal that high service quality significantly enhances customer satisfaction and fosters positive word-of-mouth, both of which contribute to strengthening customer loyalty. This research provides practical implications for restaurant managers seeking to enhance customer retention and build sustainable brand relationships in a growing regional market.

Keywords: Perceived Service Quality, Customer Loyalty, Customer Satisfaction, Positive Word-of-Mouth, Restaurant Industry

Introduction

The restaurant industry is getting very competitive and challenging as more and more people are getting into this business. This industry depends not only on quality of food but also on overall service experience. Not only in global market but also in fast expanding metropolitan areas like Birendranagar, Surkhet, business owners are considering customer loyalty as key to success. It's always affordable to keep current consumers than getting new ones in a market growingly competitive (Lemon & Verhoef, 2021). Customer impressions of a restaurant are greatly influenced by its capacity to provide consistent service and product quality. Perceived service quality increases the customer satisfaction and word-of-mouth publicity which eventually creates long term loyalty (Battistoni et al., 2022; Rasool et al., 2021). One of the key determinants of business sustainability is perceived service quality (PSQ). PSQ plays major role in service quality as well as in customer loyalty and retention. Researchers have conducted number of studies showing the direct relationship between service quality and customer loyalty in developed markets, but this relationship is unexplored in emerging cities like Surkhet.

Background of the Study

Customer loyalty is not only about increasing the frequency of purchases; it is emotional attachment of customer with service provider. This often leads to positive word of mouth (WOM). As entry in this business is easy sustainability is a major challenge as local eateries have particular difficulties including little market reach, seasonal patron flow, and tight advertising resources. Therefore, using satisfaction and WOM as strategic tools and investing in product quality would help to greatly improve customer retention. The study conducted by Nguyen et al. (2023) suggested that service quality is more often amplified by customer satisfaction and WOM into loyalty. There is another study conducted by Kim and Lee (2022) suggesting that digital platform as WOM are working as mediator in strengthening customer loyalty.

Perceived product quality shapes the customer sentiments toward a brand. That is, the assessment of a product's general excellence or superiority by the consumer (Bujistic et al., 2019; Rahman et al., 2022). In a restaurant business, this includes physical evidence, innovation, presentation of product, appearance of service providers, empathy, responsiveness and cleanliness as well as flavor, freshness, presentation, and consistency of cuisine. High perceived quality not only increases consumer happiness but also helps to generate good word-of-mouth (WOM), which is especially important for small and medium-sized businesses running in local marketplaces (Rather et al., 2022; Shafiq et al., 2023).

Customer satisfaction is well known predictor of customer loyalty. It shows the reflection of how well or beyond consumer expectations are met (Oliver, 1997). Satisfied customers are more likely to return and suggest the restaurant to others, therefore enhancing the client base by means of relational and emotional ties (Rather et al., 2021). Positive word-of-mouth customers' informal communication about a brand meanwhile increases trust among possible consumers and lowers perceived risk, especially in service industries like restaurants (Brown et al., 2005; Rosario et al., 2022).

This study impact of perceived service quality on customer loyalty in the restaurant industry of Surkhet is a first study of this kind, conducted in this topic in this area. Birendranagar, Surkhet is a developing economic center of Karnali province as well as of western Nepal. There is a cut throat competition in market with opening of numbers of café and Chiya station. Buzz, Thakali Kitchen, Kaushik, Khadka Hotel, Sidhartha, Suva, Namaste Nepal, Sumeru, Tacoma are some of the well-established one and Chiya Chautari, Kokoro, Fren's Swad, Chulo, Bardali, Momo Sansar are some of the new entry in this industry.

This paper is to investigate the direct and indirect impacts of perceived service quality on restaurant customer loyalty, mediated via customer satisfaction and favorable word-of-mouth. Doing so helps to advance theory as well as managerial practice in the regional hospitality industry. This study would provide practical insights for local restaurateurs to focus on service quality and overall customer experience. This study will contribute to both theoretical and practical implication of management theories in local context.

Statement of the Problem

There is a significant growth in restaurant industry, along with competition and customer expectations. The main strategy of restaurant owner of Surkhet is to retain old customers and attract new customers. This is a global strategy for business in the service-driven economy of today, particularly in the hospitality industry. Although the restaurant sector in Nepal, particularly developing cities like Birendranagar, Surkhet, is expanding consistently, many local businesses still find it difficult to create and maintain client loyalty. Attracting new clients is difficult; so is keeping current ones who are often affected by rivals, prices, and service discrepancies (Kotler & Keller, 2016).

According to Zeithaml et al. (2022) PSQ is one of the major determinants of customer loyalty in hospitality sector. Despite, this established relationship, the different socio-economic and cultural context of developing Nepalese city like Surkhet has not been explored yet. Nguyen et al., (2023) has questioned about validation of these western models suitability in small and informal market where personal network and WOM plays significant role. Similarly, customer satisfaction and word-of-mouth plays role of mediators in customer loyalty (Battistoni et al., 2022). The unique operational environment, employee's self-efficacy and customer expectation in this part of world yet to be tested. There is almost no empirical literature for guidance for restaurant owner creating big knowledge-to- application gap.

Researcher have noticed that in Birendranagar restaurant owners are more focused into physical evidence because of Tiktok culture rather than in perceived service quality in satisfying customer and create a buzz in local market. The customer willingness to visit and advocating about the business is mostly determined by their assessment of meal quality, cleanliness, and general eating experience (Namkung & Jang, 2007). But little study has looked at how these excellent impressions become real loyalty in small towns like Birendranagar.

Moreover, although customer happiness is generally recognized as a motivator of loyalty (Oliver, 1999), its mediation function particularly in conjunction with favorable word-of-mouth remains underexplored in regional or developing market settings (Shafiq et al., 2023). Though it is seldom used as a formal marketing tool, word-of-mouth especially in tight-knit communities can greatly enhance or harm a restaurant's reputation (Brown et al., 2005; Rosario et al., 2022). Both academic research and practical restaurant management are lacking integrated models that investigate the interaction between product quality, satisfaction, WOM, and loyalty, which highlights a vacuum in knowledge (Kumar & Anjaly, 2023; Le et al., 2023).

Given these facts, this paper intends to tackle the following research questions in restaurants industry of Birendranagar, Surkhet.

RQ1. How does perceived product quality affect customer loyalty?

RQ2. What are the mediating roles of customer happiness and positive word-of-mouth in this connection?

The results will provide practical ideas to restaurant owners and managers trying to promote loyalty and long-term consumer involvement in a competitive local market.

Research Gap

There are number of theories contributing to the examination of customer loyalty in hospitality sector. Perceived service quality major determinants of customer loyalty is developed from SERVQUAL framework (Parasuraman et al., 1988) and expectancy disconfirmation paradigm (Oliver, 1997). Recent researches have traced that customer satisfaction and positive word-of-mouth are included in this framework as mediator in reinforcement of customer loyalty (Battistoni et al., 2022; Kumar & Anjaly, 2023). Despite this well-established theoretical framework this research aims to fulfill the contextual gap that exist as Surkhet possess completely different socio-economic environment. Beside contextual gap, this research aims to address mediational mechanism gap, application gap and methodological gap.

The first research gap is contextual gap that exists as this model has never been studied in socio-economic condition of Birendranagar Surkhet. Consumer behavior of cities like Surkhet is different form cities of western countries. In smaller cities, service characters: empathy, ambience, response time might be perceived differently. Life in Surkhet is easy, slow and communal where dinning culture contradicts from western cities creates urgency of testing this theoretical model.

This is a proven hypothesis that customer satisfaction and positive WOM plays mediating role between POQ and customer loyalty. In communal social structure, where alternatives are not available, poor economic condition WOM, customer satisfaction and customer loyalty may not be the issues. Price is the major player along with personal relation and physical access. This study will test the role of mediating variables like customer satisfaction and WOM in completely different social environment.

Restaurant industry of Birendranagar Surkhet is new, privately owned by small business owner. There are no chain or franchisee restaurant owned by business housed where management theories or principles are applied and practiced. The theoretical framework of this study is derived from franchisee restaurant and chain restaurant where management theories are practiced. This creates application gap for study to be conducted. There is no evidence proving the importance of quality over physical evidence, customer satisfaction over credit sales or vice versa. Representing the different constructs from their indicators in completely unexplored environment like Surkhet creates the methodological and measurement gap.

This study in restaurant industry of Birendranagar Surkhet contextualize the well-established theoretical framework in different environment strengthening the role of mediators to universalize. This study also addresses the application and methodological gap in new socio-economic environment.

1.1. Research Objectives

Guided by an assumption of positive and significant relationship between perceived service quality and customer satisfaction, this research aims to investigate how perceived service quality affects customer loyalty in the restaurant industry of Birendranagar Surkhet. The specific objectives of this study are as follows:

   a. To evaluate how perceived service quality affects customer satisfaction, word-of-mouth and customer loyalty in restaurant business of Birendranagar Surkhet.
   b. To examine how consumer satisfaction and word-of-mouth influences customer loyalty.
   c. To assess the mediating effects of customer satisfaction and favorable word-of-mouth in the link between perceived product quality and customer loyalty.

Research Hypotheses
The following hypotheses are suggested depending on the study goals and literature review:
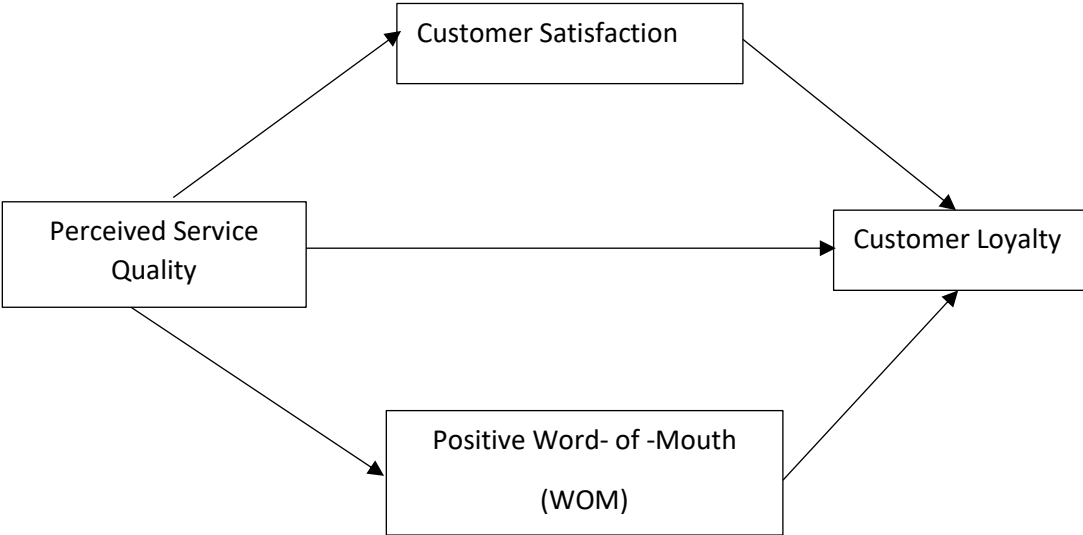
Hypotheses of Direct Effect:
   a. H_1: There is a positive and significant relationship between perceived service quality and customer satisfaction.
   b. H_2: There is a positive and significant relationship between perceived service quality and positive word-of-mouth.
   c. H_3: Customer loyalty is positively and significantly influenced by perceived service quality.
   d. H_4: There is a positive and significant relationship between customer satisfaction and customer loyalty.
   e. H_5: There is a positive and significant relationship between word-of-mouth and customer loyalty.

Hypotheses on Mediating Effects:
   a. H_6: Customer satisfaction mediates the link between perceived product quality and customer loyalty.
   b. H_7: Positive word-of-mouth serves as a mediator between customer loyalty and perceived product quality.

Conceptual Framework

Figure 1
Conceptual framework of the study

Note. The conceptual framework (adapted from Alam & Islam, 2022) illustrates the value-based perspective on brand equity.

Review and Methodology
Literature Review

This comprehensive and organized literature assessment examines the foundational theories that analysis the impact of perceived service quality on customer loyalty of Birendranagar Surkhet restaurant industry. This extensive review analyzed the theoretical landscape, exiting knowledge, research gap to draw a clear framework to understand the integrated model of this study.

Customer Loyalty and Perceived Product Quality: In restaurant business perceived service quality is a major driver of consumer loyalty. But little effort has been made in this area in Birendranagar. According to Zeithaml (1988) perceived service quality is consumer's assessment of a product's general superiority or quality. In the restaurant setting, perceived quality comprises consistency, cleanliness, presentation, and food flavor (Namkung & Jang, 2007). Many research show that more perceived quality results in more customer happiness and loyalty intentions (Ali et al.,; Jain & Gupta, 2022). Customers are more inclined to come back and suggest the restaurant to others if they see its offers as better.

Customer Satisfaction as a Middleman: Number of researches have suggested that customer satisfaction is the most important predictors of customer loyalty (Rather et al., 2020; Ali et al., 2022). In competitive market satisfaction is not enough, quality should exceed expectation to make customer loyal (Jain & Gupta, 2022). Satisfaction results, says the Expectation-Confirmation Theory, when perceived performance meets or surpasses expectations (Bhattacherjee, 2001). In the restaurant industry, responsiveness, personnel attitude, and physical evidence as well as food quality affect satisfaction (Han & Ryu, 2009; Rather et al., 2020). Studies indicate that happy consumers are more inclined to return and have more brand loyalty (Kotler & Keller, 2016; Jain et al., 2023).

Positive Word-of-Mouth: Another important predictor of customer loyalty is positive word-of-mouth (WOM). WOM is informal customer-to-customer communication regarding a product or service (Rather et al., 2022; Goyal et al., 2023). Good thing about this is it is free and automatically created when satisfaction exceeds expectation (Jain et al., 2023). Now days even in Birendranagar people check the reviews and seek for recommendation before visiting a restaurant. Business owners are aware of this. Even in Birendranagar, WOM greatly affects consumer acquisition. According to Anderson (1998), happy consumers are more inclined to participate in good WOM, which not only supports brand image but also draws new clients at minimal marketing expenses.

Restaurant Industry Customer Loyalty: According to Dick and Base (1994) frequency of visit to same business and favorable advocacy defines customer loyalty. Loyalty in restaurants is developed by means of memorable encounters, perceived value, emotional attachment, and satisfaction (Kim, Ng, & Kim, 2009). Loyal consumers are unpaid brand ambassadors and sources of long-term income. On the other hand, loyalty is delicate and has to be constantly cultivated by means of quality and trust (Oliver, 1999). Research indicates that a strong approach for maintaining loyalty may be created by combining product quality, contentment, and WOM (Han & Ryu, 2009).

Methodology

This study is based on positivist research paradigm investigating relation between customer loyalty and its predictors: perceived service quality, customer satisfaction and positive word-of-mouth (WOM). This paper adopted quantitative approach using a cross-sectional survey design and structured questionnaires to collect data. Hypotheses were tested scientifically to test the strength of relationships following a deductive approach. Convenience sampling was employed to collect responses from 300 people across various demographics to improve generalizability. The target group was restaurant customers who have dined out during the last month. Using a 5-point Likert scale for consistency, validated measures measure important constructs: perceived service quality (PSQ1, PSQ3, PSQ4, and PSQ5), customer satisfaction (CS1, CS2, CS3, and CS7), WOM (WOM2, WOM4, WOM5) and customer loyalty (BL1, BL2, BL3). Partial Least Squares Structural Equation Modeling (PLS-SEM) was used to test the hypotheses. PLS-SEM is very helpful in examining complicated correlations and mediation effects.
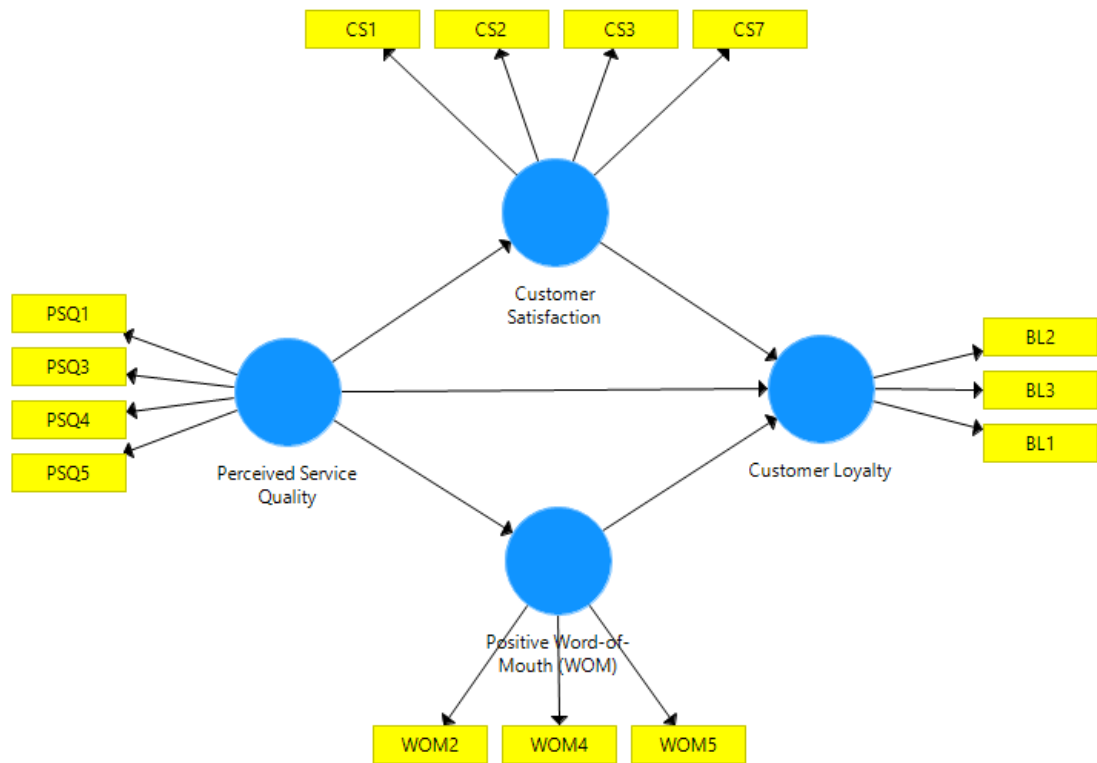
Result and Discussion
Structural Model of the Study
This structural theory model of study impact of perceived service quality on customer loyalty in the Surkhet restaurant industry: Mediating role of customer satisfaction and word-of-mouth, shows the successfully loaded indicators along with their construct. This is also referred as the inner model. The sequence of variables typically progresses from independent to dependent variables from left to right. This structural

model enables the construction of a theoretical framework to examine and substantiate the relationship among variables.

Figure 2

Structural model of the study

Note. This is a structural model of study Impact of perceived service quality on customer loyalty in the Surkhet restaurant industry: Mediating role of customer satisfaction and word-of-mouth.

Assessing the Structural Model

Table 1

Path coefficient of Structural Model

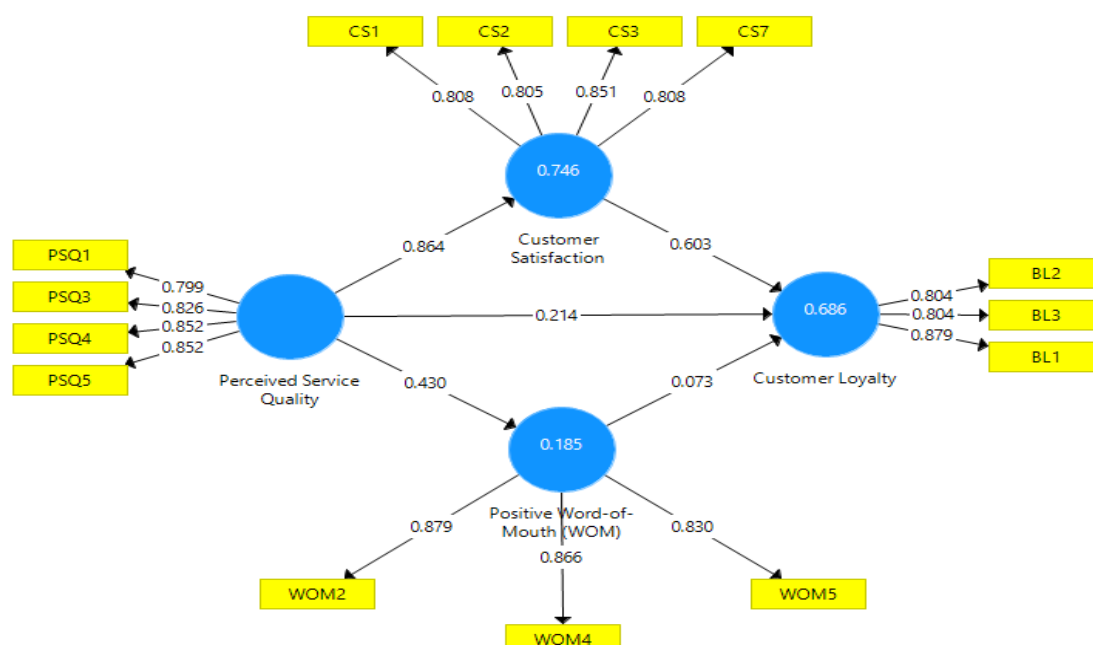|	Customer Loyalty	Customer Satisfaction	Perceived Service Quality	Positive Word-of-Mouth (WOM)
Customer Loyalty				
Customer Satisfaction	0.603			
Perceived Service Quality	0.214	0.864		0.43
Positive Word-of-Mouth (WOM)	0.073			

Note. Data derived from author's survey (2025).

This table of path coefficient shows the strength and direction of all hypothesized relationships among constructs. Result showed that all relationships are positive. Perceived service quality have strong and positive relationship with customer satisfaction and moderate relationship with customer loyalty and positive word-of-mouth. Customer loyalty is highly influenced by customer satisfaction and weakly by positive word-of-mouth.

Research model with Path Coefficient and Outer Loadings
Figure 3
Structural equation model with path coefficient and outer loadings

Note. Graphical presentation of path coefficient and outer loadings of the study.
This figure 3 is a graphical representation of path model, path coefficient and outer loadings of the study. The outgoing arrows from constructs illustrate the indicators of each construct along with their multicollinearity values. A thick arrow connecting constructs indicates the path coefficient, while the value within the constructs represents the R² value.

Assessing the Measurement Model

Table 2
Outer loading

	Customer Loyalty	Customer Satisfaction	Perceived Service Quality	Positive Word-of-Mouth (WOM)
BL1	0.879			
BL2	0.804			
BL3	0.804			

CS1	0.808		
CS2	0.805		
CS3	0.851		
CS7	0.808		
PSQ1		0.799	
PSQ3		0.826	
PSQ4		0.852	
PSQ5		0.852	
WOM2			0.879
WOM4			0.866
WOM5			0.83

Note. Data derived from author's survey (2025).

This table of outer loading shows the reliability and validity of outer loadings of the observed indicators. All items exceeded the threshold of 0.70 indicates the indicator reliability.

1.2. Collinearity Assessment

Table 3

VIF

	VIF
CL1	1.945
CL2	1.597
CL3	1.492
CS1	1.814
CS2	1.783
CS3	2.011
CS7	1.756
PSQ1	1.695
PSQ3	1.949
PSQ4	2.214
PSQ5	2.254
WOM2	1.946
WOM4	1.887
WOM5	1.734

Note. Data derived from author's survey (2025).

This table shows the VIF value which is possible multicollinearity among indicators. Data of this table are below 3.3, confirms that there is no issue of multicollinearity and each indicators are unique and explain constructs without redundancy.

Reliability and Validity

Table 4

Composite reliability and average variance extracted

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Customer Loyalty	0.773	0.778	0.869	0.689
Customer Satisfaction	0.836	0.838	0.89	0.67
Perceived Service Quality	0.852	0.853	0.9	0.693
Positive Word-of-Mouth (WOM)	0.822	0.827	0.894	0.737

Note. Data derived from author's survey (2025).

This table shows the strong consistency as composite reliability of all constructs exceeded the benchmark of 0.7, confirming construct reliability. Similarly AVE of all constructs are above 0.5 confirming convergent validity too.

Table 5

Discriminant validity

	Customer Loyalty	Customer Satisfaction	Perceived Service Quality	Positive Word-of-Mouth (WOM)
Customer Loyalty	0.83			
Customer Satisfaction	0.816	0.818		
Perceived Service Quality	0.767	0.864	0.833	
Positive Word-of-Mouth (WOM)	0.399	0.387	0.43	0.858

Note. Data derived from author's survey (2025).

This table shows that AVE of each construct is greater than the correlations between that construct with any other construct in this model indicating satisfactory discriminant validity.

Coefficient of Determination

Table 6

R Square

	R Square	R Square Adjusted
Customer Loyalty	0.686	0.682
Customer Satisfaction	0.746	0.745
Positive Word-of-Mouth (WOM)	0.185	0.182

Note. Data derived from author's survey (2025).

This table showed the explanatory power of the given model. This model demonstrated that both customer loyalty and customer satisfaction is substantial where as positive word-of-mouth is weak but acceptable.

Model Fit

Table 7

Model fit

	Saturated Model	Estimated Model
SRMR	0.079	0.079
d_ULS	0.654	0.654

Note. Data derived from author's survey (2025).

Table 7 shows the standardized root mean square residual (SRMR) value of 0.079. This shows that this model fit as its value is less than 0.08 (Hu & Bentler, 1999). The d_ULS value is 0.654 which is smaller than 1 indicating the acceptable range in PLS-SEM (Henseler et al., 2016)

Testing Hypotheses

Table 8

Bootstrapping Path coefficient of this study

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
CS -> CL	0.603	0.602	0.084	7.158	0
PSQ -> CL	0.214	0.219	0.092	2.319	0.021
PSQ -> CS	0.864	0.866	0.017	50.041	0
PSQ -> WOM	0.43	0.43	0.052	8.313	0
WOM -> CL	0.073	0.072	0.037	1.991	0.047

Note. Data derived from author's survey (2025).

This table showed that all hypothesized paths are positive and statistically significant at the level of 0.05. Among them the effect of perceived service quality on customer satisfaction is very strong. Effect of customer satisfaction on customer loyalty and effect of PSQ on Customer loyalty

Mediation Analysis

Table 9

Interpretation of mediation effect

Mediation Path	Indirect Effect	Total Effect	VAF
PSQ->CS->CL	0.520	1.318	39.45%
PSQ->WOM->CL	0.031	1.318	2.35%

Note. Data derived from author's survey (2025).

This table shows the mediation analysis of this model through Customer satisfaction and positive word-of-mouth to customer loyalty. This table demonstrate that CS is plays dominating mediation role accounting for 39.45 percent and WOM contributions only 2.35 percent on total effect.

Discussion

This study of restaurant industry of Birendranagar Surkhet examined the structural relationships between four different constructs; perceived service quality (PSQ), customer loyalty (CL) and mediating constructs:

positive word-of-mouth (WOM) and customer satisfaction (CS). The PLS-SEM provides the meaningful insights and statistical evidence about the hypothesized relationship of this model.

The measurement model of this study provides the strong evidence for the measurement and validation of constructs. All indicators loaded successfully exceeding the threshold of 0.7 are included in this study. This confirms the indicator reliability (Hair et al., 2019). All constructs show high internal consistency as composite reliability. Values are between 0.869 - 0.900, which are above the benchmark of 0.7. Similarly, AVE of each construct was greater than its correlations with other constructs. This confirms the discriminant validity (Fornell & Larcker, 1981). There is no issues of multicollinearity too as variance inflation factor (VIF) values are below threshold mark of 3.3 (Hair et al., 2019).

Customer loyalty and customer satisfaction showed the substantial exploratory power of (0.686) and (0.746) respectively. This shows that service quality is strong predictors of these constructs. Whereas coefficient of determination (R^2) of WOM is modest as its value is (0.185). The standardized root mean square residual (SRMR) is 0.079. This indicates that the model is a good fit, as its value is below 0.08 (Hu & Bentler, 1999). The d_ULS value is 0.654, which is less than 1, indicating an acceptable range in PLS-SEM (Henseler et al., 2016).

The structural model of this study showed there is significant and positive relationships between of all hypothesized constructs. PSQ has very strong positive and significant relationship with CS as T-value is 50.041 and P-value is 0.00 which aligns with the previous findings of several studies focusing on impact of perceived service quality on customer satisfaction (Ali et al., 2022). PSQ also have positive and significant effect on customer loyalty and WOM supporting hypothesis b of this study. Mediating variable CS and WOM also have positive and significant effect on CL opening the door for mediation analysis.

Customer satisfaction acts as a strong mediator in comparison to WOM as it accounts for 39.45 percent of the total effect. This finding stratified with previous findings that customer satisfaction plays vital role in translating service quality to customer loyalty (Bhattacherjee, 2001). Whereas second mediating variable has partial mediation effect of just 2.35 percent indicating that all positive word-of –mouth may not lead to customer loyalty.

Conclusion and implication

Implications

Theoretical implication: This study validates the theoretical framework of this study with the findings of the global study. It validates that perceived service quality increases the customer loyalty through number of path. One of them is through positive word-of-mouth and customer satisfaction. This study conducted in different socio-economic environment enriches the theoretical foundation of customer loyalty in global perspective.

Practical Implication: This study provides practical knowledge to business owners and managers of restaurant industry around world that service quality is main predictors of customer loyalty. Definitely customer satisfaction also plays important role in customer loyalty where WOM may be contextual.

Conclusion

In restaurant industry of Birendranagar Surkhet, perceived service quality is the most important factor of customer loyalty. This finding focused on improve the service quality of restaurant to make their customer more loyal towards their business. This finding matches with the SERVQUAL model developed by Parasurman et al. (1998) which stressed that service quality is the major predictor of customer loyalty. PSQ

also influences CL indirectly through customer satisfaction and positive word-of-mouth. In comparison to WOM CS has strong influence on customer loyalty. This finding on focusing on customer satisfaction along with service quality to make customer loyal in service industry. This finding is similar to the study conducted by Oliver (1999) which strongly emphasized that customer satisfaction is a strong mediator in the perceived service quality and customer loyalty relationships. Yoo and Donthu (2001) conducted a study to demonstrate how PSQ and costomer advocacy plays role in customer loyalty. Result of this study was similar to result conducted by them. Both customer satisfaction and customer advocacy plays mediating role in relationships of PSQ and CL.

This study provides the thoughtful insights for restaurant owners, managers even for employees about the importance service quality, customer satisfaction and positive word-of-mouth in enhancing customer loyalty.

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