Customer’s tendency towards the selection of Islamic banking system in Pakistan

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The emergence of Islamic banking system has created an immense competition among Islamic and the conventional banking system. No doubt, both banking systems are now in an immense competition with each other but the base of this competition remains the same, that is, the customer's satisfaction because these are the customers for whom all the financial services are designed. So, the customer's perception about the banking services are of utmost importance and upon their feedback, the management can take corrective measurements to improve their services. The focus of this study is to take into consideration what the Islamic banking customers think of the services being provided to them to measure their level of satisfaction. The purpose is to identify how different customers from different demographic variables correlates with our dependent variable consisting of eighteen questions under four sections, each contributing to the over all Islamic banking selection decision. There is also a need to educate the customers about Islamic banking operations and products because it has also been observed that even most of the Islamic banks customers are very much unaware of the differentiating features that Islamic banks provide. This education can be made at the educational institutions as well be providing the courses on Islamic financial systems and positively in the recent years that practiced has been started, but for current customers doing Islamic banking, alternate educational programs should be provided at the branch level.

Key words: Islamic banking, financial system, customers’ tendency, Pakistan.

INTRODUCTION

Islamic banking has been an emerging addition to the conventional banking system over the last two decades all over the world and the competition is ever increasing, not only between the conventional and Islamic banks, but now also among the various Islamic banks as, their number continues to increase. According to information released by council for Islamic Banks and Financial Institutions (CIBAFI), there are more than 284 financial institutions in the 38 countries managing US$ 250 billion. These figures exclude all those banks and financial institutions that are conventional and operating Islamic windows along with their conventional operations offering financial products and services estimating to manage about US$ 200 billion (Dusuki, 2008). But increase in the number of Islamic banks is not as important as the underlying objectives are, and their successful completion in the light and guidance of Islamic rules and regulations. The beginning of the Islamic banking system is a step in pursuing the Islamic rules and regulations in the banking operations to make it Shariah compliant. So, as the incorporation of the Islamic banking system is based on Shariah compliant, there is need to go for the profit optimization and then maximization. The view points of the stake holder’s are equally important as they are the ones who play an important role in the whole Islamic banking system whether they are customers, depositors, employees or the share holders.

The point of consideration is whether these
stakeholders’s are doing business with these Islamic banks because of profit maximization and monetary benefits or because of the Islamic beliefs that are the base of the foundation of these Islamic institutions. Another important point that will be argued in this research paper is that the Islamic banking is a step to operate a financial institution in the lights of the Islamic beliefs and teachings and in full accordance with its rules and regulations. This is a hard step because the conventional banking systems has been in operation since the Babylonians age, but does Islamic banks earn less profit or do they pay opportunity cost for being Islamic. One main point about the customer’s tendency towards Islamic banking system is to know what the objectives of the customers are due to which they opt to adopt Islamic financial system. According to Islamic bank philosophy, Islamic banking is different from conventional banks in the sense that they basically trade. Now, do the customer’s follow this philosophy, that is, do they use Islamic banking as an alternative to trade? Or do they do it as an alternative to the conventional banking system, if they do, then does it not go against the basic philosophy of Islamic banks? This issue and its implications will be discussed.

Objectives of the study

The main objectives of this study are to identify the bank selection criteria used by clients and to find whether the religious perspective is the key determinant in the bank selection criteria. Another objective is to find out the perception of the customers about the Islamic banking system and to find the factors that are deemed important by the customers to be present in the Islamic banking system and also to diagnose the areas in which the customers are not fully satisfied.

LITERATURE REVIEW

Customers do have the dominant religious perspective in the selection of the Islamic banks that includes the factors like the bank is not involved in non compliant Shariah operation, free from riba, doubtful transactions and social contribution in the form of zakat, honesty and integrity but Islamic banks should also provide quality services by not only taking advantage of the religious consciousness of the customer (Idris et al., 2011). There are many determinants for accepting the Islamic banking system like service quality, ATM operations, convenience banking and influence by the friends besides the ethnic and religious perspective, which does not have a significant impact towards the selection of the Islamic banks. In such a case, customers of the Islamic banks should be well educated and the banks must take the responsibility to describe the distinguishing features that Islamic banks provide (Marimuthu, 2010). The interest free system has been acknowledged in the Islamic as well as in the non-Islamic countries due to the fact that it does not creates the burden only on the one party and also due to the riba factor that is not only prohibited in Islam. This shows that the religious rituals is not the only factor of the customer's tendency towards the selection of Islamic banking but also the acceptance of the risk; and return sharing by the owner and user of the capital is an important factor (Ratnawati et al., 2010). The Islamic banks need to run the banking operations smoothly to run profitably as well as to attract the customers to increase their depositors. So, the competition is now with the well established conventional banking system but keeping in view the main Islamic and Shariah objectives and guidelines. Now, this poses a king of challenge as the Islamic banking products are comparatively new and so, lacks standardization which ultimately increases the transaction costs and thus creates a challenge to satisfy the new customers who had previously been satisfied with the conventional banking products and services (Al-Ajmi et al., 2009).

Compliance to Islamic principles is perceived as the most significant criteria. The main factor for customers to deal with the Islamic banks is the religious values and principles. This is also the fact that the customers perceive that the international banks offers better services, so, in order for the full-pledged Islamic banks to sustain their market positioning, they need to ensure their service quality that will enhance customer satisfaction which will ultimately boost customer loyalty. So, they have to provide good products and services instead of only relying on Islamic image and reputation (Osman et al., 2009). The customers not only considers the Islamic beliefs in the bank selection but also considers a number of factors like economic factors including costs and services, convenience like parking space, availability of ATM’s and location of branches, influence of others like family, friends, satisfaction with the banks products and services, reputation such as financial strength and risk and social responsibility, etc. (Al-Ajmi et al., 2009). Customer perception and satisfaction can be considered as the key determinants for the overall performance of Islamic banks. The provision of high standards of service quality may manage to increase customer satisfaction. Customer perception has strong relation with the three variables naming service quality, their availability and social and religious perspective as their higher level can make Islamic banking comfortable and easier (Haque et al., 2009).

In Islamic financial institution selection by the customers, the factors of importance are bank reputation, service quality, pricing and the religious conviction. As the concept of Islamic banking is comparatively new and the knowledge of Islamic finance is generally low among individual consumers, this places a huge emphasis to develop strong marketing and innovative programs to
introduce to the customers the new Islamic products and services. In context of the commercial clients of the Islamic banks, complications with the firm’s management, lack of the business conditions familiarity and sharing of risk with the borrowers serves as substantial barriers (Gait and Worthington, 2008). Customer services are the main factor that is being considered relevant by the customer in their selection of the Islamic banks. Customers highly regard the competent and knowledgeable personnel along with courteous and friendly values. Staff is one of the important factors in the customer-enhanced level of satisfaction. Adequate staff training will definitely boost the moral and competence of the employees, which will eventually serve the purpose well in maintaining and enhancing the satisfaction level of the customers (Dusuki and Abdullah, 2006). Customer's perception towards the factors that can influence their choice such as electronic services, convenience, external influences and the Islamicity of the products should be considered by the senior management. Also, the more religious customer tends to choose Islamic financing and a person is religious when he receives high formal religious exposure. The tendency to subscribe for this group about Islamic banking products is high and should be seen as potential customers (Ahmad et al., 2006). The customer choice to choose an Islamic bank comes from the strong perception that interest is riba or that placing funds or receiving financing from an Islamic bank brings ajar. Only if the consumer believes that the interest is riba then will he eliminate all conventional banks as a choice (Karim and Affif, 2005).

Decision making is viewed as a series of steps that is taken by the consumer for a product choice decision. Even though there are variations, the basic process remains the same. The main steps include problem recognition, information search, evaluation of alternatives, product choice and finally, the outcome (Solomon, 2004). Customers of Islamic banks do know about the products that are being offered like current and personal accounts, term deposits, etc., but this awareness is due to the fact that the same products have been offered by the conventional banks and most of the customers have been using them in the past, so the products information is mainly attributed to the previous banking system. Also, majority of the customer do know about the terms musharaka, mudaraba, istasna but they do not use them. Now, this is the problem, if one is totally satisfied and does know about the products then why not to use them, and the root of such problem is that the customer does know the terminology, but lacks complete and comprehensive knowledge about the product, its benefit, competitive advantage and most importantly, why it is different from the conventional banking product (Naser et al., 1999). Customer satisfaction is the customer perception or feelings about a specific product or service. A satisfied customer not only does business again and again, but also becomes a marketing tool for the company’s product by using positive word of mouth gimmick, where as, a dissatisfied customer not only feels reluctant to come again but also his dissatisfaction tends to appear through the negative word of mouth which is no doubt dangerous for not only that specific product, but also for the other products of that particular company (Metawa and Almossawi, 1998).

No doubt, Islamic banking has flourished well in the past three decades but there are many challenges that these banks have to deal with. Many of these problems are due to the abnormal environment in which these Islamic banks are operating and the others have arisen due to the practices of the Islamic banks themselves (Iqbal et al., 1998). The previous researchers have also found out that most important criteria in the selection of the banks are the delivery of fast and efficient services, image, and the reputation and the confidentiality; it has also been observed that in case of the majority of the customers, religious motivation is not the primary criteria for the selection of the Islamic banks (Erol and El-Bdour, 1989).

THEORETICAL FRAMEWORK

The dependent variable in our research study is the customer perception and preferences in choosing the Islamic bank as the banking of first choice. The demographic factors included in our study are age, gender, income level, occupation and their relation with the particular Islamic bank. The independent variables in our study are the factors that play important role and mainly include four factors consisting of impact on social and religious perspectives on the Islamic bank selection criteria, the role of courteous and knowledgeable staff on the bank selection criteria, impact of quality of services provided by the bank on the Islamic bank selection criteria and the impact of banks reputation in the Islamic bank selection criteria. Various demographic factors that play an important role in the selection of the Islamic banks have also been considered.

In this paper, we will try to see the effect of all these four independent variables on the customer’s perception and preferences in their selection of the Islamic banks and to find out which of these variables influences the customer perception at the highest level so that in the conclusion stage, we will be able to suggest a strategy to streamline the factors and processes to enhance the level of customer satisfaction which is the objective of our study.

Hypothesis

H1: Social and religious perspective has a positive relation with selection of Islamic banks.
H2: Courteous and knowledgeable staff has a positive relation with selection of Islamic banks.
H3: Quality of services has a positive relation with selection of Islamic banks.
H4: Bank’s reputation has a positive relation with selection of Islamic banks.

METHODOLOGY

We try to obtain the customer’s feedback on the self-administered questionnaires that will be floated to different customers of the Islamic banks. The questionnaire consists of 18 questions that are distributed in four different sections; each section represents factors that mainly influence the customer’s banking selection perceptions and these effects will be measured by applying various statistical tests. A pilot study has also been conducted, which consisted of 10 questionnaires from different customers to obtain their feedback on how to improve the questions that would help us to tap the effect of the independent variables more accurately. The questionnaires had been floated among different Islamic bank customers visiting in different branches in different official timings so as to minimize any possible biasness. These questionnaires had been given to the customers visiting the banks either for their deposits, withdrawal, ATM usage or as walk in customers to obtain feedback at the same place in order to maximize the response rate of the respondents. For that purpose, the questionnaire had been designed precise and short so that the customers do not find it uneasy to fill. The questionnaires are designed as close ended and on five point Likert scale for the customers convenience. Kruskall Wallis test has been applied as the data is randomly gathered and therefore is non parametric in nature.

Data from one hundred and fifteen respondents from different Islamic banks has been collected and the eighteen factors have been tested as a measure of the dependent variables and the five demographic variables are taken as the independent variables. The banks from where the data has been collected include Meezan bank Limited, Bank Islami, Albaraka Islamic banks and Islamic Windows of the Standard Chartered, United bank limited and Muslim commercial bank limited. The impact of these demographic independent variables on the customer’s choice of banking with the Islamic banks has been tested and the correlation of these variables with all the dependent variables has been tested and was basically divided into four main factors.

DATA ANALYSIS

Impact on social and religious perspectives as the Islamic bank selection criteria

Five questions have been included in the factor considering the impact of social and religious perspectives on the Islamic banking selection criteria. The gender of the customers has a significant relation with the ethical practices that the bank exercises, whereas age factor has a positive impact on the religious nature of the Islamic banks as a common observation because as a person enters in the senior age, he/she becomes more conscious about the Islamic concerns and interest free banking. Customer’s relation with the bank has a significant relationship with the religious motives behind the Islamic banks operations. This shows that the customers who are the account holders instead of walk in customers have more concern with the motives and Islamic concepts behind the Islamic banking operations (Table 1).

The role of Courteous and knowledgeable staff on the bank selection criteria

Four questionnaires have been included in this factor that is taken as a dependent variables which measures the role of courteous and knowledge staff on the Islamic bank’s Islamic criteria. Age has an impact on the friendly personnel of the bank employees that shows that the customers with different age groups have different expectations with the employees that are providing services in the banks. Also, the demographic variable income has an impact and shows significant relationship with the knowledge personnel of the employees showing that individuals with higher income are concerned with the knowledge that the Islamic banking staff have and this knowledge plays important role in influencing the customers with different age groups (Table 2).

Impact of quality of services provided by the bank on the Islamic bank selection criteria

Employees that have banking relations are more concerned with the long service hours that the banks provide to accommodate its customers and also with the online banking services that the bank provides. Also, employees having different banking relations are

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**Table 1.** Impact on Social and religious perspectives as the Islamic bank selection criteria data was collected from the sample in 2011 and results of the Kruskall Wallis test are given below with the significance level.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Gender</th>
<th>Age</th>
<th>Relation</th>
<th>Income</th>
<th>Nature</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\chi^2$</td>
<td></td>
<td>$\chi^2$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Religious reasons</td>
<td>0.005</td>
<td>13.659</td>
<td>9.286</td>
<td>5.828</td>
<td>0.513</td>
</tr>
<tr>
<td>Ethical practices</td>
<td>2.902</td>
<td>3.600</td>
<td>1.766</td>
<td>2.461</td>
<td>0.285</td>
</tr>
<tr>
<td>Confidence in Shariah</td>
<td>0.342</td>
<td>5.823</td>
<td>0.379</td>
<td>4.832</td>
<td>0.645</td>
</tr>
<tr>
<td>Friendly features</td>
<td>1.364</td>
<td>5.614</td>
<td>3.714</td>
<td>3.218</td>
<td>0.627</td>
</tr>
<tr>
<td>Religious obligations</td>
<td>2.088</td>
<td>3.676</td>
<td>0.075</td>
<td>1.706</td>
<td>0.532</td>
</tr>
</tbody>
</table>

**Significance at 5%, ***significance at 10%**
The role of Courteous and knowledgeable staff on the bank selection criteria data was collected from the sample in 2011 and results of the Kruskall Wallis test are given below with the significance level.

<table>
<thead>
<tr>
<th>Variable</th>
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<tbody>
<tr>
<td></td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
</tr>
<tr>
<td>Knowledgeable personnel</td>
<td>0.002</td>
<td>0.968</td>
<td>2.756</td>
<td>0.599</td>
<td>0.100</td>
</tr>
<tr>
<td>Friendly personnel</td>
<td>0.814</td>
<td>0.367</td>
<td>8.638</td>
<td>0.071***</td>
<td>1.135</td>
</tr>
<tr>
<td>Quality of advice</td>
<td>0.780</td>
<td>0.377</td>
<td>2.485</td>
<td>0.647</td>
<td>3.695</td>
</tr>
<tr>
<td>Friendly personnel</td>
<td>1.974</td>
<td>0.160</td>
<td>3.560</td>
<td>0.469</td>
<td>1.212</td>
</tr>
</tbody>
</table>

**Significance at 5%, ***significance at 10%

The Impact of Quality of services provided by the bank on the Islamic bank selection criteria data was collected from the sample in 2011 and results of the Kruskall Wallis test are given below with the significance level.

<table>
<thead>
<tr>
<th>Variable</th>
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<tbody>
<tr>
<td></td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
</tr>
<tr>
<td>Long service hours</td>
<td>1.564</td>
<td>0.211</td>
<td>7.480</td>
<td>0.113</td>
<td>4.795</td>
</tr>
<tr>
<td>Online banking</td>
<td>0.321</td>
<td>0.571</td>
<td>0.679</td>
<td>0.954</td>
<td>4.588</td>
</tr>
<tr>
<td>Low service charges</td>
<td>0.060</td>
<td>0.807</td>
<td>5.536</td>
<td>0.237</td>
<td>2.502</td>
</tr>
<tr>
<td>Effective transactions</td>
<td>0.467</td>
<td>0.494</td>
<td>3.273</td>
<td>0.513</td>
<td>0.323</td>
</tr>
<tr>
<td>Range of facilities</td>
<td>1.062</td>
<td>0.303</td>
<td>3.123</td>
<td>0.537</td>
<td>4.791</td>
</tr>
</tbody>
</table>

**Significance at 5%, ***significance at 10%

The Impact of banks reputation in the Islamic bank selection criteria data was collected from the sample in 2011 and results of the Kruskall Wallis test are given below with the significance level.

<table>
<thead>
<tr>
<th>Variable</th>
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<th>Age</th>
<th>Relation</th>
<th>Income</th>
<th>Nature</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
<td>Sig.</td>
<td>$\chi^2$</td>
</tr>
<tr>
<td>Reputation and image</td>
<td>0.283</td>
<td>0.595</td>
<td>10.123</td>
<td>0.038**</td>
<td>0.833</td>
</tr>
<tr>
<td>Confidence in directors</td>
<td>0.323</td>
<td>0.570</td>
<td>5.975</td>
<td>0.201</td>
<td>0.536</td>
</tr>
<tr>
<td>Network of branches</td>
<td>0.329</td>
<td>0.566</td>
<td>2.679</td>
<td>0.613</td>
<td>0.968</td>
</tr>
<tr>
<td>Financial strength</td>
<td>0.169</td>
<td>0.681</td>
<td>1.064</td>
<td>0.900</td>
<td>3.450</td>
</tr>
</tbody>
</table>

**Significance at 5%, ***significance at 10%

centered with the range of facilities that are provided with the bank and are cautious as the results shows significance with the range of facilities that are being offered. Employees with different jobs and business class showed concerns with the long service hours that the banks provides as most of the service class is willing to make transaction with the banks after their service hours and find it convenient (Table 3).

Impact of banks reputation in the Islamic bank selection criteria

Customers had a positive response regarding the questions about Islamic bank’s reputation and the age variable showed high significance with the reputation and image of the Islamic banks. Also, the nature of the services as an independent variable also showed significant results with the reputation of the bank as well as with the network of branches. This seems logical as the persons with different business and high career professionals are concerned with the online banking system because of the official tours and various outstation business meetings (Table 4).

Conclusion

Customers are the main stakeholders in any organization and they are the customers for whom all services are being provided. As banks are the service providers, so for banks, customers play a very important role. For Islamic banks, the factors are even more important because, now, with the arrival of Islamic banks, especially from the last two decades, the competition has gained tremendous importance. In this paper, we have discussed the impact of the demographic variables on the choice of the customers, and their perception in the selection of the
Islamic banking system. All the demographic variables have some impact on our dependent variables showing correlation with the variables that are important to the Islamic banking selection decision made by the customers. Bank reputation, range of facilities, religious reasons and long service hours seems to have a high impact on the selection criteria along with the network of branches, online systems and friendly personnel and ethical practices.

The management and Shariah advisor’s of the Islamic banking systems should take decisions to make their customers more satisfied with the products and services they are providing them.

There are a number of factors that do not show any significant relationship in our study and are included. This does not mean that they do not have any relationship, the relationship exists but their impact is not up to that extent that can significantly change the perception of the Islamic banking customers. The ethical behavior of the front office staff does have a major impact on employee customer relationship. To enhance long term relationship with the customers, an environment has to be achieved in which the potential for unethical behavior is minimum.

LIMITATIONS

Limitations of this study are that there are a number of variables that do not have significant relationship with the selection criteria or decisions made by the customers about the Islamic banking system. These variables do have an impact but the extent is small, so, in future, more relevant variables can be included to tap the responses by the customers.

Also, there can be a number of other Islamic banks from where the data can be gathered to increase the number of observations including the Islamic windows of number of other banks. There are also geographical restrictions as the data in this study is from the branches of Islamabad and Rawalpindi; in the future, the geographical area can be extended to get the more generalized perception and responses of the customers of the Islamic banking system.

There can also be other factors that can be included in the future studies in this area which can have more significant impact on the perception and Islamic banking decisions taken by the customers.

REFERENCES

ANNEXURE

Relation with the Islamic banking system

Walk in customer
Account holder
ATM User

1- Strongly agree  2- Agree  3- Neutral  4- Disagree  5- Strongly disagree

Impact of social and religious perspectives on Islamic bank selection criteria

To what extent you believe that you choose Islamic banking system because of religious reasons only ___

To what extent you believe that the Islamic banking system has an active participation in ethical environmental practices and positive involvement in the community (for example, giving donations, scholarships) ____

To what extent do you have confidence in the bank's Shariah's supervisory committee ____

To what extent you are satisfied with the social and friendly features of Islamic working environment ____

To what extent do you believe that the Islamic bank also observes Shariah's principle fulfillment of religious obligations ____

The role of courteous and knowledgeable staff on the Islamic bank selection criteria

To what extent you want to deal with knowledgeable and competent personnel in the Islamic banks ____

To what extent you want to deal with the customer services personnel that are friendly in nature ____

To what extent do you believe in the quality of advice offered by the bank's personnel ____

To what extent do you believe that the social and friendly features of bank's personnel are an important criteria in the Islamic bank selection ____

Impact of quality of services provided by the bank on the Islamic bank selection criteria

To what extent do you think that the customer service quality hours of operation should be available ____

To what extent do you think that the availability of online banking meets your need for products and services ____

To what extent do you think that the Islamic banks have low service charges as compared to the other conventional banks ____

To what extent you are satisfied with the bank's effectiveness in completing transactions ____

To what extent you are satisfied with the wide range of facilities offered by the bank ____

Impact of banks reputation in the Islamic bank selection criteria

To what extent do you think that the Islamic bank's reputation and image plays a key role in Islamic bank's selection ____

To what extent do you have confidence in the bank's board of directors and Shariah's advisors ____

To what extent do you think that the network of branches can be a factor in the Islamic bank's selection ____

To what extent do you think that the financial strength and soundness is an important factor in choosing any bank ____